(1)

90-1008

NO. _____

IN THE
SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1990

CONNECTICUT OFFICE OF CONSUMER COUNSEL
CONNECTICUT DEPARTMENT OF PUBLIC UTILITY CONTROL
CONNECTICUT ATTORNEY GENERAL, Petitioners,

v.

FEDERAL COMMUNICATIONS COMMISSION
UNITED STATES OF AMERICA, Respondents,

AMERICAN TELEPHONE AND TELEGRAPH COMPANY, Intervenor.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BILL KOWALSKI
136 Main St., Suite 501
New Britain, CT 06051
(203) 827-7887
Counsel of Record

CLARINE NARDI RIDDLE
ATTORNEY GENERAL
STATE OF CONNECTICUT

ROBERT S. GOLDEN
One Central Park Plaza
New Britain, CT 06051
(203) 827-2620
Counsel for Petitioner

QUESTIONS PRESENTED

1. Whether the Second Circuit Court of Appeals erred in upholding a Federal Communications Commission decision which failed to find that a national long distance telephone company surcharge which passed the expense of a state gross receipts tax back to ratepayers in that state alone, while allowing the pooling and averaging of all other taxes and business expenses of that company over all of its customers nationwide, violated 47 U.S.C. § 201(b) and 202(a) as unjust and unreasonable geographic rate discrimination?

2. Whether the Second Circuit Court of Appeals erred in upholding the Federal Communications Commission's denial of the Petitioners' request for an evidentiary hearing, in light of the significance of the public policy matters at issue, the lack of a cost study on the record and the genuine issues of material fact raised before the agency?

LIST OF PARTIES

The parties to the proceedings below were the Petitioners Connecticut Office of Consumer Counsel, James F. Meehan, then-Consumer Counsel,[1] Connecticut Department of Public Utility Control, Peter G. Boucher, Chairman, and Clarine Nardi Riddle, Attorney General for the State of Connecticut. The Respondents were the Federal Communications Commission and the United States of America. The American Telephone and Telegraph Company was an intervenor in the proceedings below.

---

[1]On January 12, 1990, James F. Meehan was appointed Connecticut's Commissioner of Revenue Services and thus relinquished his position as Consumer Counsel. His assistant, Eugene M. Koss was appointed, and currently serves as, Acting Consumer Counsel.

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Statutes

IN THE SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1990

CONNECTICUT OFFICE OF CONSUMER COUNSEL, CONNECTICUT DEPARTMENT OF PUBLIC UTILITY CONTROL, CONNECTICUT ATTORNEY GENERAL, Petitioners,

v.

FEDERAL COMMUNICATIONS COMMISSION AND THE UNITED STATES OF AMERICA, Respondents,

AMERICAN TELEPHONE AND TELEGRAPH, Intervenor.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

The Petitioners respectfully pray that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Second Circuit, entered in the above-entitled proceeding on September 20, 1990.

OPINIONS BELOW

The opinion of the Court of Appeals

for the Second Circuit is reported at 915 F.2d 75, and is reprinted in the appendix hereto, p. 1a, infra.

The memorandum decision of the Federal Communications Commission is reported at 4 FCC Rcd 23, and is reprinted in the Appendix to this Petition at 15a, et seq., infra.

JURISDICTION

Invoking federal jurisdiction under 47 U.S.C. §§ 201, 202 and 208, Petitioners filed a complaint with the Federal Communications Commission on March 18, 1988. On November 16, 1989 the Federal Communications Commission dismissed the Petitioners' complaint. See Appendix, p. 1a, et seq., infra.

On September 20, 1990, the Second Circuit entered a judgment and an opinion denying the Petitioners' Petition to

review the Federal Communications Commission Order. See p. 1a, infra. No petition for rehearing was sought.

The jurisdiction of this Court to review the judgment of the Second Circuit is invoked under 28 U.S.C. § 1254(1).

STATUTES INVOLVED

§ 201. Service and charges

(a) It shall be the duty of every common carrier engaged in interstate or foreign communication by wire or radio to furnish such communication service upon reasonable request therefor; and, in accordance with the orders of the Commission, in cases where the Commission, after opportunity for hearing, finds such action necessary or desirable in the public interest, to establish physical connections with other

carriers, to establish through routes and charges applicable thereto and the divisions of such charges, and to establish and provide facilities and regulations for operating such through routes.

(b) All charges, practices, classifications, and regulations for and in connection with such communication service, shall be just and reasonable, and any such charge, practice, classification, or regulation that is unjust or unreasonable is declared to be unlawful: Provided, That communications by wire or radio subject to this chapter may be classified into day, night, repeated, unrepeated, letter, commercial, press, Government, and such other classes as the Commission may decide to be just and reasonable, and different charges may

be made for the different classes of communications: Provided further, That nothing in this chapter or in any other provision of law shall be construed to prevent a common carrier subject to this chapter from entering into or operating under any contract with any common carrier not subject to this chapter, for the exchange of their services, if the Commission is of the opinion that such contract is not contrary to the public interest: Provided further, That nothing in this chapter or in any other provision of law shall prevent a common carrier subject to this chapter from furnishing reports of positions of ships at sea to newspapers of general circulation, either at a nominal charge or without charge, provided the name of such common carrier is displayed along with such ship position reports. The Commission may

prescribe such rules and regulations as may be necessary in the public interest to carry out the provisions of this chapter.

§ 202. Discriminations and preferences

(a) It shall be unlawful for any common carrier to make any unjust or unreasonable discrimination in charges, practices, classifications, regulations, facilities, or services for or in connection with like communication service, directly or indirectly, by any means or device, or to make or give any undue or unreasonable preference or advantage to any particular person, class of persons, or locality, or to subject any particular person, class of persons, or locality to any undue or unreasonable prejudice or disadvantage.

(b) Charges or services, whenever referred to in this chapter include charges for, or services in connection with, the use of common carrier lines or communication, whether derived from wire or radio facilities, in chain broadcasting or incidental to radio communication of any kind.

(c) Any carrier who knowingly violates the provisions of this section shall forfeit to the United States the sum of $500 for each such offense and $25 for each and every day of the continuance of such offense.

STATEMENT OF THE CASE

More than $65 million of monies paid by Connecticut customers of AT&T are at stake in this proceeding. As a result of the FCC's approval of changes in the

interstate telecommunications tariffs of AT&T, substantial changes in longstanding national telecommunications policy occurred without cost studies or an opportunity for evidentiary hearings. No hearings were held at anytime, despite repeated requests. The FCC denied those requests both at the time the changes were proposed and at the time the Petitioners' complaint was filed with the FCC under 47 U.S.C. 208. The Court's grant of this Petition is vital to the protection of the significant public interests at issue in this matter.

In March, 1986, AT&T filed a proposed amendment of Tariff FCC No. 1 and Tariff FCC No. 2, to create a surcharge which would flow-through to its customers in Florida, the gross receipts tax levied upon AT&T by that State. See Connecticut Office of Consumer Counsel

et. al. v. AT&T Communications, FCC 89-315, (November 16, 1989), ("FCC Decision"), at paragraph 2. After approval of the Florida gross receipts tax surcharge, on April 24, 1986, the Common Carrier Bureau of the Federal Communications Commission ("FCC" or "Commission") approved additional amendments to Tariff FCC Nos. 1 and 2, submitted by AT&T Communications ("AT&T"), which allowed AT&T to flow-through to its customers in Connecticut and eight other states gross receipts taxes levied by those states as well. Id. Prior to the implementation of the surcharges, such gross receipts tax expenses were pooled with all of AT&T's other costs of doing business and collected through nationally averaged rates. Id. at par. 15. No evidentiary

hearings were held with regard to these charges.

Through the surcharge as it applied to Connecticut, AT&T sought to recover not only the 9% direct taxation of its own interstate switched service revenues, but also the supposed effect of Connecticut's 9 percent gross earnings tax upon Connecticut's primary local telephone company, The Southern New England Telephone Company ("SNET"). FCC Decision at par. 10. AT&T alleged that the 9 percent tax on SNET's interstate access revenues increased its cost of purchasing "access" or its connection with the local telephone system in Connecticut. Id.

Petitions to review the above-referenced actions of the FCC were first filed by the Vermont Public Service Board, the Vermont Department of Public

Service, and the Maine Public Advocate. Id. at par. 2. Those appeals, filed in the First and Second Circuit Federal Courts of Appeals, were consolidated at the First Circuit. Id. at par. 2. These petitions were dismissed for lack of a final judgment. Id. In the dismissal, the Court did provide, however, that:

> (P)etitioners remain free to file a complaint under (47 U.S.C.) Section 208 to challenge the lawfulness of the tariffs and obtain an appealable final order. If, as petitioners claim, the F.C.C. order does not specifically invite petitioners to file a Section 208 complaint regarding the flow-through of gross receipts taxes -- but does invite a complaint as to other types of taxes -- that circumstance does not detract from petitioners' statutory right under Section 208 to file a complaint as to gross receipts taxes.
>
> Maine Public Advocate, et. al. v. F.C.C., et. al., 828 F.2d 68, 69 (1st Cir. 1987) (emphasis added).

The Connecticut Parties filed such a complaint pursuant to 47 U.S.C 208 with the FCC, challenging AT&T's gross receipts tax surcharge, on March 18, 1988. Pursuant to Section 208 of the Federal Communications Act of 1934, 47 U.S.C. 208, it alleged violations of 47 U.S.C. §§ 201(b) and 202(a), which require that, inter alia, all rates for identical or "like" services be "just and reasonable."

The complaint specifically alleged that AT&T's practice of passing the expense of its gross receipts taxes in Connecticut, directly to its Connecticut ratepayers through a surcharge, while averaging all other types of tax expenses and costs of providing service in other states nationwide, subjected Connecticut AT&T customers to unjustly higher rates

for services identical to those provided by AT&T in every other state in the Union. The complaint also alleged that the surcharge itself was incorrectly calculated, and overcollected AT&T's actual Connecticut gross receipts tax expense.

The FCC dismissed the Connecticut Parties' complaint, finding, inter alia, that the tax expense was properly excluded from nationally averaged costs, that the surcharge was a "just and reasonable" means of collecting the tax expense, and that the surcharge was properly calculated.

The FCC dismissed the Connecticut Parties' quantitative data as "irrelevant" with no substantive analysis, failed to examine any cost impacts of the proposed surcharge in its decision, and failed to cite authority

for its ability to make subjective, unsupported policy decisions in the face of contrary substantive evidence.

On December 27, 1989, the Connecticut Parties filed a Petition to Review the Order of the FCC with the United States Court of Appeals for the Second Circuit. In that Petition, the Connecticut Parties raised six claims of error, two of which are raised before the Court in this Writ.

On September 20, 1990, the Second Circuit Court of Appeals denied the Connecticut Parties' Petition, finding in favor of the FCC on all counts. The two issues raised for review before this Court are whether the Court improperly found that no unjust or unreasonable discrimination occurred in the creation of the AT&T gross receipts tax surcharge in Connecticut, and whether the FCC

committed reversible error by failing to grant a hearing on this significant policy change.

The Second Circuit Court of Appeals upheld the FCC decision claiming that the Commission's actions were "well within its broad authority." 915 F.2d 75, 79. The Court found that the gross receipts tax surcharge ("GRTS") was a "reasonable exception" to the Commission's policy of averaging fixed costs, concluding that states otherwise would have an incentive to target interstate telecommunications companies as unreasonable sources of revenue. Id. The Second Circuit further found that GRTS stabilized the process of "averaging fixed costs," agreeing with the FCC that it "'limit[ed] a state's ability and incentive to shift its tax burden to customers in other states through the averaging process.'" Id.

The Court also found it was appropriate to treat gross receipts tax differently from other forms of state taxation. Id.

Addressing a related argument, the Second Circuit Court of Appeals rejected the Connecticut Parties' contention that Connecticut consumers already subsidize ratepayers in "high cost" states, that is, those states in which AT&T's cost of providing service on per customer basis is much higher than in Connecticut, a small, densely populated state.

The Connecticut Parties expressly stated in their Brief and in oral argument, however, that subsidization of "high costs" states by "low cost" states, like Connecticut, was proper and consistent with the Federal Communications Act of 1934 only when resulting in nationally averaged rates. The implementation of the surcharge,

however, moved the subsidization to a level beyond that required to create a nationally-averaged pool of rates, and caused ratepayers in Connecticut to pay rates which not only paid a portion of all taxes and expenses paid in other states, but also paid the entire cost of Connecticut's gross receipts tax. The result was the "de-averaging" of a single cost, and the destruction of the longstanding policy of nationally averaged rates, a goal expressly acknowledged by the FCC in its decision on the Petitioners' 47 U.S.C. 208 complaint. FCC Decision at par. 14.

With regard to the second claim of error raised in this Petition, the Second Circuit found that the FCC's failure to hold an evidentiary hearing in light of the circumstances of this case was not reversible error. 915 F.2d 81. The

Court of Appeals found "no relevant factual issues and controversy and no need for a factual hearing." Id. The Petitioners would contend, however, that under the facts of the instant case, a major, substantive issue of fact to be addressed in this proceeding was the issue of whether Connecticut was a high or low cost state. Moreover, at the FCC, the Connecticut Parties entered the testimony of Ben Johnson, Ph.D, a nationally renowned utility rates analyst, who submitted written testimony raising the following genuine issues of material fact: AT&T's cost of serving its Connecticut customers, the appropriate calculation of that portion of the surcharge which collects Connecticut's gross earnings tax on local telephone company access charges; the similarity of taxing schemes pooled

nationally and those collected through a surcharge; the levels of tax expenses paid by AT&T on a state-by-state basis; and the equivalence of the Connecticut gross earnings tax to personal property taxes levied in other states. As a result, the Second Circuit committed reversible error by upholding the FCC's denial of the Petitioners' request for a hearing, given the significance of the factual matters in dispute.

As indicated above, the amount of monies at issue in Connecticut alone exceeds $65 million, for the period during which the surcharge was in effect. During that time, nine other states also levied gross receipts taxes upon telecommunications companies, and thus were subject to AT&T's GRTS. 915 F.2d 77. The Connecticut gross receipts tax was repealed effective January 1,

1990. Nationwide, the monies at issue likely exceed hundreds of millions of dollars.

A change in utility regulatory and ratemaking policy of great significance has occurred without so much as a cost study or an evidentiary hearing before the Federal Communications Commission. As significant a change in federal communications policy as is indicated herein should not be implemented without an opportunity for an examination and hearing on the genuine issues of significant material fact raised by Petitioners in their complaint filed pursuant to 47 U.S.C. 208.

REASONS FOR GRANTING THE WRIT

I.

The Second Circuit's Finding That AT&T's Gross Receipts Tax Surcharge Did Not Constitute Unjust And Unreasonable Discrimination Is Not Supported on the Record and is Contrary To Significant Ratepayer And Consumer Interests.

As indicated in the Second Circuit decision in this matter, the Communications Act of 1934 ("the Act") created the Federal Communications Commission "for the purpose of regulating interstate and foreign commerce in communication by wire and radio so as to make available ... a rapid, efficient, Nation-wide ... communication service with adequate facilities at reasonable

charges." 47 U.S.C. Section 151 (1982). 915 F.2d 78.

As was indicated at the outset of this Petition, the Act, at § 201(b), provides that "all charges, practices, classifications, and regulation for and in connection with such communication service, shall be just and reasonable, and any such charge, practice, classification, or regulation that is unjust or unreasonable is declared to be unlawful."

Similarly, § 202(a) of the Act also provides that:

> It shall be unlawful for any common carrier to make any unjust or unreasonable discrimination in charges, practices, classifications, regulations, facilities, or services for or in connection with like communication service, directly or indirectly, by any means or device, or to make or give any undue or unreasonable preference or advantage to any particular person, class of

> persons, or locality, or to subject any particular person, class of persons, or locality to any undue or unreasonable prejudice or disadvantage.
>
> 47 U.S.C. § 202(a) (emphasis added).

The Second Circuit's decision provided that the interstate long distance service provided to Connecticut consumers by AT&T is "like" the services provided to consumers in other states. 915 F.2d 78-79. Moreover, the Court agreed that the GRTS is "discriminatory in the literal sense that it is paid by Connecticut consumers but not by consumers in many other states." Id. at 79. As the Second Circuit correctly indicated, "[t]he issue at hand is whether the Commission's determination that the rate differential represented by the GRTS is not unjust or unreasonable is a rational one." Id..

In upholding the Commission's decision, however, the Second Circuit's decision relied on a faulty legal and logical foundation.

The Second Circuit supported the GRTS as a "reasonable exception" to the policy of averaging fixed costs, because without it, the Court contended, states obtained an incentive to target telecommunications companies as a source of revenue by exporting their tax burden. Id.

Despite this alleged incentive, and despite the long history of taxation of utility gross receipts in Connecticut and other states, the record is devoid of any evidence that "[a]ny person, any body politic or municipal organization, or state commission," had ever filed a complaint with the FCC or the courts alleging discrimination or injury

resulting from "tax exportation." In addition, the Petitioners provided written expert testimony before the FCC indicating that all state taxation of interstate commerce resulted in "tax exportation."

It is also significant to note, that the only ratepayer involvement in the GRTS approval process was the opposition of ratepayer advocates from various states, urging the need for an evidentiary hearing and the rejection of the de-averaging of the national cost pool. See e.g., Maine Public Advocate v. FCC, 828 F.2d 68 (1st Cir. 1987). It was AT&T's proposed surcharge, and not the taxation of utility gross receipts which constituted a discriminatory de-averaging of AT&T's national costs of service. If, in the 100-plus years since the State of Connecticut first taxed utility gross

receipts, for example, any party sufferedfrom any alleged abuse of its taxation abilities, the record would have indicated such complaint. No such complaint has been documented on the record of this case in any state in the Union. The FCC's substantial policy change and not the original policy of pooling and averaging rates created the problem -- unreasonably discriminatory rates -- it allegedly sought to resolve.

The inequity of the Second Circuit's decision is best highlighted by the decisions cited by the Petitioners in their reply brief to the Second Circuit. In striking down an analogous surcharge proposed at the state level to collect a municipal franchise fee from only those utility customers living within the municipality, the Colorado Supreme Court stated:

> [B]ecause of the disparity in the utility's] cost between rural and municipal service, it was admitted that municipal customers have always "subsidized" rural customers. This occurs because the costs to the utility are divided equally among all ratepayers when rates are first determined, regardless of differences in cost of service.
>
> City of Montrose v. PUC, 197 Co. 119, 590 P.2d 502, 505 (1970).

The Petitioners proffered written testimony at the FCC which indicated that AT&T's cost of doing business in Connecticut was lower than the national average. The FCC claimed, however, that no evaluation of costs beyond the amount of the surcharge was required. FCC Decision at par. 18. The Agency further stated that such data was "irrelevant" to its resolution of the petitioner's claims. Id. at par. 14. Moreover, the

Second Circuit misconstrued Petitioners' arguments, stating that:

> "Petitioners would thus have the Commission allow 'low cost' states to impose gross receipts taxes to the point that the fixed costs of service in their states approximate those in 'high cost' states. The Commission was surely correct in rejecting that contention as inconsistent with averaging."
>
> 915 F.2d 80.

The Second Circuit simply missed the point. The Petitioners contended that a proper resolution of the issue of deaveraging gross receipts taxes required an examination of the utility's costs of doing business, and that even an initial review indicated that Connecticut AT&T customers subsidized national rates prior to the implementation of the GRTS. Given the FCC self-professed desire to implement a policy which "represents the

allocation of specific costs directly to the originator of those costs"; FCC Decision at par. 16; the Petitioners illustrated that the situation in Connecticut was already inconsistent with this goal, and that the approval of the GRTS exacerbated that inconsistency.

The Colorado Supreme Court in City of Montrose v. PUC, supra, recognized the problems inherent in shaping utility rate policy without examining costs, and rejected a resultant surcharge as arbitrary and capricious:

> There was no study done in this case to determine how costs of service for a natural gas utility break down along municipal/non-municipal lines, although counsel for the Commission admitted that such a study is feasible. Nor was there any discussion in the Commission's order of the disparate service costs between municipal and non-municipal customers. The order was issued solely as a matter of administrative convenience. We

> find the order to be arbitrary, capricious, and invalid.
>
> City of Montrose v. PUC, supra, at 506.

The Colorado Supreme Court's reasoning was adopted in subsequent state decisions, and should be adopted by the Court in the present case as well. Accord, Colorado Municipal League v. P.U.C., 197 Co. 106, 591 P.2d 577 (1979) (en banc); ("Value of service should be the polestar of rate regulation; ideally, rates should not be fragmented according to isolated groups and special expenses.") Colorado Municipal League v. P.U.C., 198 Co. 217, 597 P.2d 586 (1979) (en banc) (1 judge concurring in part and dissenting in part); Colorado-Ute v. Public Utilities, ___ Co. ___, 760 P.2d 627, 648 (1988) (en banc), appeal dismissed, 109 S. Ct. 1333 (1989) (Agency's failure to perform

cost-of-service study constitutes arbitrary and capricious ratemaking.) See also City of Cincinnati v. PUC, 55 Ohio St. 2d 168, 378 N.E.2d 729, 734 (1978) (1 judge dissenting), cert. denied, 440 US 912 (1979),(uniform rate for utility service in both rural and urban areas became appropriate as rural costs of service significantly decreased while urban costs increased.)

The Petitioners have demonstrated on the record that even without a cost study, the de minimis cost of gross receipts taxes to AT&T cannot justify the substantial impact of the GRTS on ratepayers. For example, Connecticut's levy of gross receipts taxes represents only .068 percent, or less than 1/10 of 1 percent of AT&T's total cost of service. Nationwide, AT&T's gross receipts tax

expense is only .5 percent or 1/2 of 1 percent of AT&T's total interstate operating expenses. Yet the impact of the GRTS on Connecticut ratepayers alone was over $65 million in just three and one-half years.

The Petitioners' request for an evidentiary hearing to examine cost-based information was denied by the FCC and that denial was upheld by the Second Circuit. Without a cost study on the record, a sound policy was not possible and the decision rendered without such data was arbitrary, capricious and contrary to the significant public interests at stake in this proceeding.

The Second Circuit's decision also found that "the success of a few states in exporting their tax burden via interstate telephone rates would cause other states to impose their own gross

receipts taxes in response." 915 F.2d 79. The Court claimed that the FCC, in essence, "nipp[ed] that prospect in the bud ...." Id. This observation is factually flawed, as indicated above, the long-standing existence of gross receipts taxes nationwide far exceeded the creation of a surcharge by decades. As indicated to the Court and agency below, Connecticut taxed telecommunications gross receipts since 1913 under the same statutory scheme. AT&T's surcharge, on the other hand, was created in 1986. Therefore, the present form of taxation existed in Connecticut for nearly 75 years without "abuse." The AT&T surcharge can hardly be seen as "nipping" any prospect in the bud, as the established practice of gross receipts taxation had long since flowered into a recognized and equitable means of taxing

utilities. Moreover, as indicated above, 47 U.S.C.§ 208 provided and continues to provide a more than sufficient means by which to attack any inequitable usage of a state's gross receipts taxation mandate. A finding under 47 U.S.C. 208 that a gross receipts tax scheme was unjust or unreasonable would remedy any alleged discrimination without creating unreasonable discrimination embodied in the Gross Receipts Tax Surcharge.

Moreover, as indicated in the expert testimony filed on behalf of the Connecticut Parties at the FCC, genuine issues of material fact were raised which indicated that all states export their taxation of interstate telecommunications providers on differing levels and through differing means (e.g. corporate versus income versus property versus gross receipts tax). Such testimony also

illustrated that the variety of taxing schemes in the 50 states served as an incentive rather than a disincentive for retaining gross receipts taxes within AT&T's nationwide pool of expenses, and indicated why all taxes should be treated identically:

> Most governmental entities use some combination of taxing mechanisms as a form of diversification, since there is no such thing as a perfect tax. A diversified and balanced tax system has the potential for creating a more favorable business climate, lessening taxpayer discontent, and provide for stability of revenue throughout the course of the business cycle....For example, the District of Columbia charges a sales tax, a property tax, a gross receipts tax, and a corporate income tax. In contrast, Texas charges a sales tax, a property tax, a gross receipts tax (but only on local exchange service), but no corporate income tax. Not only the mix but also the rates will vary from place to place. For example, state sales and gross receipt taxes are 3 percent in Colorado, Wyoming, North

> Carolina, and Georgia; 6 percent in Minnesota, Mississippi, New Jersey, Pennsylvania, Rhode Island, and the District of Columbia; and 6.5 percent in Washington....Differences such as these are found throughout the United States, and their number and complexity help explain why, under AT&T's current tariffs, all the various taxes are included in the nationally averaged interstate cost of service and thus are reflected in AT&T's nationally averaged rates. All of them, that is, except gross receipts taxes, under the recently adopted surcharge approach.
>
> Written Testimony of Ben Johnson, Ph.D, before the FCC, Second Circuit Joint Appendix, p. A-237-238.

The Second Circuit has failed to address the arguments raised by the Connecticut Parties on anything other than a superficial level. Given the substantial issues of fact disputed by the parties, the substantial written testimony presented by the parties, and the significant public policy interests

at issue, a superficial analysis of the Connecticut Parties' claims is insufficient for a just and reasonable resolution of the matters before the Court. Therefore, plenary consideration of the matter by the Court is essential.

II.

The Denial Of An Evidentiary Hearing Constitutes An Abuse Of Discretion Under The Circumstance Of The Instant Case.

The Second Circuit upheld the FCC's denial of the Connecticut Parties' request for hearing on this matter citing no precedent and providing no discussion of its rationale. The discussion in its entirety read as follows:

> Finally, petitioners argue that it was reversible error for the

> Commission to have denied their request for a hearing on this matter. We disagree. There were no relevant factual issues in controversy and no need for a factual hearing.
>
> 915 F.2d 81.

As indicated above, the Connecticut Parties raised genuine issues of material fact concerning a substantial number of issues in the case. Those questions of material fact included AT&T's cost of serving its Connecticut customers, the appropriate calculation of that portion of the surcharge which collects Connecticut's gross earnings tax and local telephone company access charges, the similarity of taxing schemes pooled nationally and those collected through a surcharge, the levels and tax expenses paid by AT&T on a state-by-state basis, and the equivalence of the Connecticut gross earnings tax to personal property

taxes levied in other states. Thus, the FCC's own standard for determining whether to exercise its discretion was met. In its Brief to the Second Circuit, the FCC cited the case of The Offshore Telephone Company, 2 FCC Rcd 4546, 4556-67 (1987). In that case, denial of a request for hearing was allowed when

> No party to this proceeding has provided a basis for a conclusion that the oral examination of witnesses was necessary to resolve the issues in this proceeding or would make a difference in its outcome. Rather, it was clear from the entire record that material facts were not in dispute ....
>
> Id. at 4556.

As indicated at the Second Circuit, oral examination and cross-examination into disputed factual matters were necessary to resolve the issues in this proceeding. Again, the superficial

review and examination of the issues in this case provided by the Second Circuit require the review of this procedural matter further, especially in light of the significant public policy impacts at issue, the vast sums of money at issue in Connecticut and across the nation, and the significance of the change in FCC policy allowed without a cost study or hearing on the matter.

CONCLUSION

For these various reasons, this petition for Writ of Certiorari should be granted. If the Petitioners are correct in urging that the Second Circuit has incorrectly denied the petition to review the Order of the Federal Communications Commission, the matter should be remanded

to the FCC for appropriate disposition, after a full development of the facts through an evidentiary hearing.

Respectfully submitted,

BILL KOWALSKI
136 Main Street, Suite 501
New Britain, CT 06051
(203) 827-7887
Counsel of Record

CLARINE NARDI RIDDLE
ATTORNEY GENERAL
STATE OF CONNECTICUT

ROBERT S. GOLDEN
One Central Park Plaza
New Britain, CT 06051
(203) 827-2620
Counsel for Petitioner

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 1191—August Term, 1989

(Argued: June 6, 1990 Decided: September 20, 1990)

Docket No. 89-4157

CONNECTICUT OFFICE OF CONSUMER COUNSEL, JAMES F. MEEHAN, CONSUMER COUNSEL, CONNECTICUT DEPARTMENT OF PUBLIC UTILITY CONTROL, PETER G. BOUCHER, CHAIRMAN OF THE DEPARTMENT OF PUBLIC UTILITY CONTROL, AND CLARINE NARDI RIDDLE, ATTORNEY GENERAL, STATE OF CONNECTICUT,

Petitioners,

—v.—

FEDERAL COMMUNICATIONS COMMISSION AND UNITED STATES OF AMERICA,

Respondents,

AMERICAN TELEPHONE AND TELEGRAPH COMPANY,

Intervenor.

Before:

KEARSE, WINTER and WALKER,
Circuit Judges.

Petition for review of a final decision of the Federal Communications Commission denying petitioners' complaint that a gross receipts tax surcharge collected by AT&T in Connecticut was unjustly and unreasonably discriminatory in violation of 47 U.S.C. §§ 201(b) and 202(a), and denying petitioners' request for a hearing on the complaint.

Petition denied.

BILL KOWALSKI, Senior Staff Attorney, Connecticut Office of Consumer Counsel, New Britain, Connecticut (Clarine Nardi Riddle, Attorney General for the State of Connecticut; Robert S. Golden, Jr., Rachael Davis, Assistant Attorneys General, Connecticut Department of Public Utility Control, New Britain, Connecticut, of counsel), *for Petitioners.*

JOHN E. INGLE, Deputy Associate General Counsel, Federal Communications Commission, Washington, D.C. (James F. Rill, Assistant Attorney General, Robert B. Nicholson, Robert J. Wiggers, United

States Department of Justice, Washington, D.C.; Robert L. Pettit, General Counsel, Laurel R. Bergold, Federal Communications Commission, Washington, D.C., of counsel), *for Respondents*.

DAVID W. CARPENTER, Chicago, Illinois (Peter D. Keisler, Sidley & Austin, Chicago, Illinois; Francine J. Berry, Judy Sello, Basking Ridge, New Jersey, of counsel), *for Intervenor*.

WINTER, *Circuit Judge*:

This petition involves rates for interstate telephone service charged by intervenor American Telephone and Telegraph Company ("AT&T") to its customers in Connecticut. Specifically, we are asked to examine a surcharge collected by AT&T from its Connecticut customers in order to recover the expense of a gross receipts tax imposed on AT&T by the State of Connecticut. Petitioners, various Connecticut state officials, seek review of a decision of the Federal Communications Commission denying petitioners' complaint that the surcharge was unjustly and unreasonably discriminatory in violation of 47 U.S.C. §§ 201(b) and 202(a) and denying their request for an administrative hearing on the complaint. Because the surcharge was a reasonable method of preventing states from singling out telecommunications for taxation in order to transfer a portion of their tax burden to non-residents via rates for interstate telephone service and because there are no material factual issues in dispute, we deny the petition.

BACKGROUND

1. *The Calculation of Interstate Rates*

The Federal Communications Commission ("FCC" or "Commission") has broad regulatory authority over the formulation of rates for interstate telephone calls. *See* 47 U.S.C. §§ 152, 201(b) (1982). The rates permissibly charged by a telecommunications company (or "carrier") are based on the costs incurred by that carrier in providing interstate telephone service. For carriers that offer both intrastate and interstate service, the FCC, working with a Federal-State Joint Board, allocates costs between intrastate and interstate service, and itself supervises the recovery of interstate costs, leaving recovery of intrastate costs to the oversight of state regulatory authorities. *National Ass'n of Reg. Util. Comm'rs v. FCC*, 737 F.2d 1095, 1105 (D.C. Cir. 1984), *cert. denied*, 469 U.S. 1227 (1985) ("*NARUC*").

The interstate costs isolated by this "separations process" are further segregated into two components. One component, "traffic sensitive" or variable costs, represents costs to the carrier that vary with the intensity of telephone use. The greater the number of calls made, or the longer the duration of any one call, the higher is the traffic sensitive cost. The other component, "nontraffic sensitive" or fixed costs, represents costs that are incurred by a carrier independent of the intensity of telephone use. This would include, for example, the cost of telephone wires, which are equally necessary for one call or a hundred. *See NARUC*, 737 F.2d at 1104.

A carrier recovers traffic sensitive costs directly from charges to the individual end users of its telephone services. A carrier's fixed costs, however, except for an iso-

lated component that is recovered from end users, *see NARUC*, 737 F.2d at 1109-10, are recovered through an averaging process. Through the National Exchange Carrier Association ("NECA"), interstate fixed costs are "pooled" nationwide and divided equally amongst all of a carrier's consumers. The purpose of the averaging process is to ensure the existence of a nationwide telecommunications network and to avoid gaps in that network in areas of high fixed costs relative to use.

Generally included in the NECA pool are the taxes—such as property or income taxes—paid by a carrier to the states in which it operates. As a result of the pool system, therefore, taxes paid by a carrier to any one state are usually borne in equal proportion by all of its customers in all of the states in which it operates.

2. *The Gross Receipts Tax Surcharge*

One type of tax that states have imposed on selected businesses is a "gross receipts tax." This tax is levied against all the revenues collected by particular kinds of companies within the state. Ten states, including Connecticut, have assessed a gross receipts tax on the revenue of telecommunications companies.

Some carriers do not include the costs of gross receipts taxes in the NECA pool but rather seek to recover such taxes from their customers in the states that impose the particular tax. By means of a "gross receipts tax surcharge" ("GRTS") these carriers "flow through" the gross receipts tax directly to telephone users in the taxing state. The GRTS collected by AT&T from its Connecticut customers is the subject of the instant litigation.

3. *Procedural History*

In March 1986, AT&T filed a tariff amendment with the FCC to "establish a tariff provision to flow through any utility or telecommunications taxes imposed on AT&T Communications' interstate gross receipts to customers in the jurisdiction imposing the tax." AT&T first collected a GRTS in Florida, and then extended the practice to eight more states, including Connecticut. The FCC denied various petitions for suspension or rejection, and the GRTS took effect. Petitions for review filed in the First and Second Circuits were consolidated in the First Circuit and dismissed in September 1987 on the ground that denial of a motion to suspend a tariff is not a final judgment of an administrative agency and thus is not subject to appellate review. *See Maine Public Advocate v. FCC*, 828 F.2d 68 (1st Cir. 1987).

On March 18, 1988, petitioners filed with the FCC the complaint in the instant matter. It alleged that AT&T, in collecting a GRTS in Connecticut, violated 47 U.S.C. §§ 201, 202 and 208, because the GRTS "subject[ed] Connecticut customers to undue and unreasonable discrimination, disadvantage, and prejudice." Specifically, petitioners argued that the GRTS imposed discriminatory prices upon Connecticut consumers for "like" services. They contended that AT&T, by flowing through the Connecticut gross receipts tax directly to Connecticut customers only, while pooling other fixed costs nationwide, forced Connecticut consumers to pay higher rates for interstate telephone services than paid by consumers in the other states in which AT&T operates. This was especially unfair, charged petitioners, in that AT&T's fixed cost of service in Connecticut is lower than the national average and Connecticut consumers

thus already bear a larger share of fixed costs than those in "high-cost" states. Separately, petitioners alleged that the GRTS, even if permissible as a matter of principle, was calculated incorrectly because it permitted AT&T to overcollect the cost of Connecticut's gross receipts tax by "double counting" deductible expenses and ignoring the time value of money. As relief, petitioners demanded that AT&T be restrained from imposing the GRTS on Connecticut customers, that AT&T be forced to refund all GRTS monies collected in Connecticut, and that a hearing be held on the complaint. Discovery commenced, and written testimony and briefs were submitted to the FCC.

The Commission dismissed petitioners' complaint. *Connecticut Office of Consumer Counsel v. AT&T Communications*, FCC 89-315 (Nov. 16, 1989) ("Order"), found that the GRTS was a "just and reasonable" method of recovering a gross receipts tax expense. Without such a provision, the Commission reasoned, "states would have an incentive to target telecommunications carriers for special tax burdens and thereby export the cost of the tax to customers in other states." *Id.* at 3. Thus, the rate differental caused by the GRTS was "not unjust or unreasonable discrimination." *Id.* The Commission also ruled that petitioners had proffered no evidence to support their assertion that AT&T computed the GRTS incorrectly. Finally, the Commission ordered that petitioners' motion for a hearing be denied on the ground that there were no relevant questions of fact in controversy that required full evidentiary proceedings. *Id.* at 4.

We agree with the Commission and deny the petition for review.

DISCUSSION

In reviewing the actions of the Commission,[1] we apply the usual deferential scope of review and will not overturn the Commission's order unless its decision was "arbitrary, capricious, . . . or otherwise not in accordance with law." 5 U.S.C. § 706(2)(A) (1988). Furthermore, as a specialized agency, the Commission enjoys broad discretion in carrying out its ratemaking duties, *see, e.g.*, *Permian Basin Area Rate Cases*, 390 U.S. 747, 800 (1968); *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 602 (1944); *AT&T v. FCC*, 572 F.2d 17, 23-24 (2d Cir.), *cert. denied*, 439 U.S. 875 (1978), and we will not disturb the decision below if the agency has "provide[d] a coherent and reasonable explanation of its exercise of discretion." *MCI Telecommunications Corp. v. FCC*, 675 F.2d 408, 413 (D.C. Cir. 1982).

Petitioners' principal argument is that the GRTS collected by AT&T in Connecticut was unjustly or unreasonably discriminatory in violation of 47 U.S.C. §§ 201(b) and 202(a). We disagree.

The Communications Act of 1934 ("the Act"), created the Federal Communications Commission "[f]or

---

1 The Commission contends that, as state agencies and officials, petitioners may seek injunctive relief, but not damages, on behalf of citizens. Given that Connecticut has rescinded the gross receipts tax in question and that, consequently, AT&T no longer collects a GRTS in that state, any request for injunctive relief would be moot. The Commission concedes, however, that petitioners have standing to seek damages in their proprietary capacity as ratepaying customers of AT&T formerly subject to the GRTS, and that such standing is sufficient for us to hear the appeal. The question of whether petitioners may seek damages for Connecticut citizens in a representative capacity would arise only if we were to reverse the Commission's order. Because we deny the petition for review, we need not address this issue further.

the purpose of regulating interstate and foreign commerce in communication by wire and radio so as to make available . . . a rapid, efficient, Nation-wide . . . communication service with adequate facilities at reasonable charges." 47 U.S.C. § 151 (1982). Pursuant to this mandate, Congress empowered the Commission to "make such rules and regulations, and issue such orders . . . as may be necessary." *Id.* at § 154(i).

With respect to rates, the Act broadly provides that "[a]ll charges, practices, classifications, and regulations for and in connection with such communication service, shall be just and reasonable, and any such charge, practice, classification, or regulation that is unjust or unreasonable is declared to be unlawful." *Id.* at § 201(b). Similarly, the Act also states:

> It shall be unlawful for any common carrier to make any unjust or unreasonable discrimination in charges, practices, classifications, regulations, facilities, or services for or in connection with like communication service, directly or indirectly, by any means or device, or to make or give any undue or unreasonable preference or advantage to any particular person, class of persons, or locality, or to subject any particular person, class of persons, or locality to any undue or unreasonable prejudice or disadvantage.

Id. at § 202(a).

There is no question that the telephone service AT&T provides to Connecticut consumers is "like" the service it provides to consumers in other states. Nor is it disputed that the GRTS is discriminatory in the literal sense that it is paid by Connecticut consumers but not

by consumers in many other states. The issue at hand is whether the Commission's determination that the rate differential represented by the GRTS is not unjust or unreasonable is a rational one.

Petitioners argue that the GRTS surcharge undermines the entire process of averaging fixed costs. They contend that allowing AT&T to pass through the costs of the Connecticut gross receipts tax directly to Connecticut consumers via the GRTS is "antithetical to the intent of the . . . Act" and "inconsistent with the operation of a pooled-cost system." In their view, the pass-through precedent threatens to unravel the policy of nationwide averaging. Moreover, they contend, it is arbitrary for the Commission to permit local recovery of the GRTS because other types of state taxes levied against carriers—such as property and income taxes—are recovered through nationwide averaging.

We believe the Commission's actions are well within its broad authority. The Act does not require equal rates for all customers. Rather, it requires only that rate differentials between consumers for like service be "just and reasonable." 47 U.S.C. § 201(b). The averaging of fixed costs is thus not compelled by the statute but has been adopted by the Commission as a means of ensuring that basic telecommunications services are available nationwide and will not be foreclosed in areas where fixed costs tend to be high relative to use. The Commission found that the GRTS was a reasonable exception to this policy because without it, states would have an incentive to target telecommunications companies as sources of revenue, with the bulk of the tax incidence ultimately falling on out-of-state residents through nationwide averaging.

The Commission's logic is unassailable. Absent a GRTS, a gross receipts tax is a political and financial windfall to states imposing it because a state's coffers can be filled largely at the expense of persons in other states. Indeed, the record suggests that the prospect of this windfall influenced Connecticut's retention of the gross receipts tax over alternative forms of taxation. *See Order* at 5 n.19.

As the Commission noted, far from undermining the averaging of fixed costs, the GRTS stabilizes that process by "limiting a state's ability and incentive to shift its tax burden to customers in other states through the averaging process." *Id.* at 3. Without the GRTS, the success of a few states in exporting their tax burden via interstate telephone rates would cause other states to impose their own gross receipts taxes in response. The result would be an upward-spiraling of interstate telephone rates to a level bearing no relation to actual costs of service. Nipping that prospect in the bud is well within the Commission's mandate "to make available . . . a rapid, efficient, Nation-wide . . . communication service with adequate facilities at reasonable charges." Indeed, an attack on the Commission's ruling in the name of telecommunications consumers is surprising because they as a nationwide group will face ever-rising rates in the absence of a pass-through mechanism.

Furthermore, as the Commission explained, it is reasonable to treat gross receipts taxes and other forms of state taxation differently. Gross receipts taxes are unique in that they target a particular industry—in this case, telecommunications companies. In contrast, property and income taxes are broad-based, and their burdens fall for the most part on residents who are represented

in the state's political process. Property and income taxes do not single out an industry that must average its fixed costs nationwide by regulatory order and therefore do not offer an opportunity to transfer the burden of the tax to non-residents. Thus, while a pass-through mechanism is necessary in the case of a gross receipts tax, it is not needed for these other types of taxes.

Petitioners' second argument is that the Commission should have considered AT&T's costs of doing business in Connecticut because AT&T's cost of serving Connecticut is lower than the national average and that Connecticut consumers already subsidize ratepayers in "high-cost" states. To ask that these consumers also assume the entire burden of Connecticut's gross receipts tax, they argue, allows AT&T to earn an excessive rate of return in Connecticut and unjustly discriminates against Connecticut ratepayers.

In contrast to the earlier contention that the GRTS must be rejected because it threatens to undermine nationwide averaging, this argument attacks the GRTS because it *prevents* the undermining of nationwide averaging. Petitioners would thus have the Commission allow "low-cost" states to impose gross receipts taxes to the point that the fixed costs of service in their states approximate those in "high-cost" states. The Commission was surely correct in rejecting that contention as inconsistent with averaging.

Petitioners offer a third, and far-fetched, argument that the Commission erred in not using disparate impact analysis to consider petitioners' claim of discrimination. They contend that once evidence of differential treatment was presented, the Commission should have assigned AT&T the burden of proving that the GRTS

was either a "business necessity" or the least discriminatory means of serving the desired end.

We reject this argument out of hand. Disparate impact analysis is appropriate in the area of employment discrimination against members of racial, ethnic, religious or gender groups. Disparate impact analysis is useful in such cases to identify facially neutral practices that in fact discriminate illegally, *see, e.g., Griggs v. Duke Power Co.*, 401 U.S. 424 (1971), because such invidious discrimination is often subtle and difficult to detect. It borders on the ridiculous to suggest that such analysis should be imported into this very different area. There is no claim that AT&T has singled out Connecticut ratepayers because it dislikes citizens of that state (or the eight others subject to a GRTS) as a group. It merely seeks to recover what is concededly a cost of doing business in Connecticut. Disparate impact analysis has no place in this context.

Petitioners also contend that even if the GRTS collected by AT&T from its Connecticut customers is valid in principle, the Commission erred in failing to scrutinize the way in which the surcharge was actually calculated. They complain that AT&T may have been able to "double-recover" a portion of the gross revenue tax levied against telecommunications companies.

The GRTS collected by AT&T recovered two types of gross receipts taxes imposed by Connecticut. The first was a direct 6.5% tax on the revenues of interstate carriers. The second was a 9.0% tax on the revenues of local carriers that derived from charges to interstate carriers for access to local telephone networks ("access charges"). Presumably interstate carriers indirectly bore

the burden of this second tax in the form of increased access charges.

Connecticut law permitted interstate carriers to deduct access charges in determining their own gross revenue tax liability. In approving the GRTS, however, the Commission allowed AT&T to include a component recovering that portion of access charges paid that were attributable to the tax on local carriers' access charge revenues. Petitioners object on two grounds. First, they argue that conceptually this scheme allows AT&T to double-recover the tax on local carriers' access charge revenues. Second, they argue that the Commission erred in not confirming that the local carrier indeed did pass along the tax on access charge revenues to AT&T. If it did not pass along the tax, argue petitioners, AT&T recovered a cost it did not incur.

We agree with the Commission that because AT&T did not include access charges paid in the base from which it computed recovery of the direct gross revenue tax on its own revenue, no double recovery occurred as a logical matter. We also reject petitioners' second argument. They did not advance this theory before the Commission and offer us no reason now to believe that the tax on local carriers' access charge revenue was not passed along to AT&T.

Finally, petitioners argue that it was reversible error for the Commission to have denied their request for a hearing on this matter. We disagree. There were no relevant factual issues in controversy and no need for a factual hearing.

Petition denied.

APPENDIX

Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of

CONNECTICUT OFFICE OF CONSUMER COUNSEL, JAMES F. MEEHAN, CONSUMER COUNSEL,
CONNECTICUT DEPARTMENT OF PUBLIC UTILITY CONTROL, PETER G. BOUCHER, CHAIRMAN OF THE DEPARTMENT OF PUBLIC UTILITY CONTROL, AND JOSEPH I. LIEBERMAN, ATTORNEY GENERAL, STATE OF CONNECTICUT.

Complainants.

v. File No. E-88-061

AT&T COMMUNICATIONS.

Defendant.

MEMORANDUM OPINION AND ORDER

Adopted: November 2, 1989; Released: November 16, 1989

By the Commission:

1. On March 18, 1988, the above-listed complainants ("complainants" or COCC") filed a complaint pursuant to 47 U.S.C. § 208 against AT&T Communications (AT&T)

for the imposition of a gross receipts tax surcharge on interstate long distance calls originating in Connecticut. The surcharge compensates AT&T for a tax on interstate communications which it pays to the State of Connecticut. Complainants allege that this surcharge discriminates against Connecticut customers. Complainants request, inter alia, that AT&T be prohibited from imposing a gross receipts tax surcharge (GRTS) on Connecticut customers and that AT&T be ordered to refund, with interest, the GRTS collected from Connecticut customers. For the reasons discussed below, we deny the complaint.

I. BACKGROUND AND CONTENTIONS OF THE PARTIES

2. In March 1986 AT&T filed a tariff amendment with this Commission to "establish a tariff provision to flow through any utility or telecommunications taxes imposed on AT&T Communications' interstate gross receipts to customers in the jurisdiction imposing the tax." Tariff F.C.C. No. 1 and Tariff F.C.C. No. 2, Transmittal No. 562, effective April 24, 1986. The original gross receipts tax surcharge was imposed on customers in Florida. Subsequently AT&T filed Transmittal No. 604, modified by Transmittal No. 628, which, inter alia, extended the gross receipts tax flow through to eight additional states, including Connecticut.[2] The Common Carrier Bureau denied petitions for suspension or rejection and the tariff took effect. AT&T Communications Tariff F.C.C. Nos. 1 and 2, Transmittal Nos. 604

and 628, Mimeo No. 4868 (released May 30, 1986) (May 30 AT&T Order). The Commission affirmed the Bureau ruling. 2 FCC Rcd 548 (1987) (Review Order). Petitions for review filed in the First and Second Circuits of the United States Court of Appeals were consolidated in the First Circuit Court of Appeals. These petitions were dismissed on September 14, 1987, on the grounds that action on a motion to suspend a tariff was not a final judgment and thus not subject to review by the Court of Appeals. Maine Public Advocate v. FCC, 828 F.2d 68 (1st Cir. 1987). In May and November 1987 AT&T again filed tariff revisions affecting the GRTS on calls originating in Connecticut. Tariff F.C.C. Nos. 1 and 2, Transmittal Nos. 604, filed May 15, 1987, and Transmittal No. 628, filed November 17, 1987.

3. COCC argues that the gross receipts tax surcharge is unjust and unreasonable under 47 U.S.C. § 201(b) and also violates 47 U.S.C. § 202(a) by subjecting Connecticut customers to undue and unreasonable discrimination, disadvantage, and prejudice. It maintains that the GRTS imposes discriminatory prices for Connecticut customers for "like" services.[3] According to COCC this discrimination, disadvantage and prejudice arises from various factors. First, it alleges that AT&T's cost of providing service is lower in Connecticut than the national average. It represents, however, that Connecticut customers must not only pay the higher average national rate, but in addition the GRTS. Complainants conclude that this amounts to discriminatory rates for like services received by Connecticut

customers from AT&T compared with customers in other states. Second, COCC attacks AT&T's practice of "flowing through" one cost of service, namely gross receipts taxes, while pooling other costs, such as corporate or property taxes. Complainants contend that flowing through selected tax cost items without considering low cost factors or call volumes allows AT&T to earn an excessive rate of return in Connecticut. Third, COCC maintains that AT&T's tariff permits it effectively to deaverage rates for selective costs, "thus creating geographical deaveraging in violation of the Federal Communications Act." Id. at 6.

4. Specifically, COCC asserts that once it is determined that the service being provided under the tariff is a "like" service, the burden of justifying

any discrimination is upon the carrier. Moreover, it contends that a cost of service analysis must be the basis for determining if rates are unjustly discriminatory. In this regard, it contends that neither requiring customers in a low cost state to pay higher than average costs nor permitting AT&T to "arbitrarily" flow through gross receipts taxes while pooling all other costs is defensible on a cost-based analysis. Complainants cite ITT World Communications, 30 FCC 2d 101 (1970), to support their argument that the Commission recognizes two standards under which discriminatory treatment is not considered to be unlawful or unreasonable -- competitive necessity and differences in the cost of providing the service. It dismisses both of these as possible justifications for the GRTS. Despite

advancing this argument, COCC indicates that the Commission has recognized a third exception -- public policy concerns.[4] COCC argues, however, that this exception is not without limitation. Anticipating that AT&T would contend that its GRTS is justified by policy concerns, COCC states that "AT&T puts great stock in its claims that it need not pay to Connecticut a gross receipts tax because such a tax targets a particular industry, one not represented as a "constituent" of the taxing legislature." Initial Brief at 35. According to COCC, AT&T implies by this argument that there must be a link between the taxed party and the state. COCC asserts that there is such a link, and that the taxation of AT&T, and not of its customers, is a proper exercise of the taxation powers of the State of

Connecticut. It maintains that the GRTS enables AT&T to bypass its responsibility to Connecticut to compensate the state for services received.

5. Finally, COCC argues that even if the gross receipts tax surcharge is permissible under the Communications Act, it is calculated incorrectly. The gross receipts tax surcharge imposed by Connecticut is only 6.5 percent. Nevertheless, it states, AT&T's surcharge has been 7.33 percent since January 1, 1988.[5] According to COCC, AT&T explains the discrepancy by a need to offset "the 9 percent utility gross receipts tax imposed by Connecticut on the local exchange carrier's gross receipts, which AT&T pays through interstate switched access charge[s] ...." Initial Brief at 41, quoting AT&T's Answer at 4. COCC maintains that this is an arbitrary and

improper overcharge since the Connecticut legislation allows for a deduction of the access charges AT&T pays to local exchange carriers in Connecticut. Therefore, complainants assert, to "raise the amount of its gross receipts tax surcharge in Connecticut to "offset" the gross receipts taxes paid by the LECS and allegedly passed on to AT&T through the LEC access charges, unjustly allows AT&T to collect for taxes which Connecticut, by statute, deducts from AT&T's tax liability." Initial Brief at 43. COCC alleges that AT&T receives a double benefit by obtaining the deduction according to the statute and still charging the customers a surcharge calculated as if the deduction had not been taken. Further, COCC claims that the GRTS is incorrectly calculated because AT&T collects the surcharge from

the customers on a monthly basis while it is only required to pay the state on a quarterly basis. Thus, it concludes, the surcharge fails to take into account the time value of money.

6. In its opposition, AT&T argues that its gross receipts tax surcharge is "revenue neutral."[6] It explains that by "flowing through" the utility gross receipts tax that Connecticut and only a few other states impose on interstate telecommunications, AT&T recovers state taxes on interstate gross receipts directly from customers in the state imposing the tax rather than by including them in its averaged national rates. It maintains that this eliminates incentives for states to target telecommunications carriers for special tax burdens which would artificially raise the costs of interstate telecommunications. In the

absence of a GRTS, according to AT&T, the state imposing the tax would receive the benefits of the tax, but would export most of the burdens of the tax to customers in other states.

7. AT&T argues that the GRTS is just and reasonable. It maintains that it is irrelevant whether Connecticut is a high-cost or low-cost state (nevertheless, it contends that Connecticut is a high-cost, rather than a low-cost state). It dismisses COCC's contentions that Sections 201(b) and 202(a) of the Communications Act, 47 U.S.C. §§ 201(b) and 202(a), require that rates be based exclusively on costs. As evidence that Section 202(a) allows the Commission to consider other factors than cost in determining if rates are "just and reasonable," AT&T points out that it is required to charge the same rates for

low- and high-cost routes. It maintains that different rates for like services are "reasonable" under Section 202(a) if there is "a neutral, rational basis underlying apparently disparate charges"[7] or "if they promote the "national economic and social polic[ies]" underlying the Communications Act."[8] AT&T maintains that its gross receipts tax "flow-through tariff epitomized the 'neutral, rational' measures that cannot violate Section 202(a) and that, indeed, promote overriding Commission policies." Opposition at 9.

8. AT&T maintains that contrary to COCC's allegations, it is reasonable to treat gross receipts taxes differently than other expenses. First, gross receipts taxes are unique in that they provide states with an incentive to enact such taxes, thereby exporting their tax

burdens. It maintains that no other cost of service provides such incentives.[9] By contrast, states AT&T, the taxes which are included in the nationally averaged rates are taxes of general applicability, i. e., taxes that are imposed on all businesses or individuals within a state. Because only a small portion of these taxes is reflected in the nationally averaged rates, the burden of these taxes is borne principally by the residents of the state which imposed them. Likewise, the amount of other costs which are included in nationally averaged rates is a function of matters outside the control of a single state, such as the age of the plant and the terrain. There is no incentive to increase non-tax costs, and therefore there is no need to flow-through such expenses. AT&T states that under its

tariffs, it flows through all state taxes that have the characteristics of the Connecticut gross receipts tax.[10]

9. Moreover, according to AT&T, there is no inconsistency between a gross receipts tax surcharge and nationally averaged rates. AT&T disputes that the GRTS will create geographical deaveraging of rates. Indeed, it argues, states have flowed through local or municipal gross receipts taxes for years, and that has not led to general intrastate deaveraging. According to AT&T, both state courts and public utility commissions have recognized that flowing through local or municipal gross receipts taxes prevents destabilization of averaged intrastate rates, and many have concluded that not flowing through special taxes would amount to unreasonable discrimination against non-resident ratepayers.[11]

10. Finally, AT&T argues that the surcharge is properly calculated. It explains that the surcharge, currently 6.77 percent,[12] is set to recover the 6.5 percent tax levied by Connecticut on AT&T's interstate switched services revenues (net of access and other deductions) and the 9.0 percent tax on the local exchange carriers' (LECs) interstate access revenues, which is flowed through to AT&T as higher access charges.[13] AT&T states that its computation of the surcharge takes into account the access charge deduction. It first determines the amount it expects to pay in gross receipts taxes directly, 6.5 percent of revenues minus access charges. To that it adds the gross receipts tax expense which the LECs collect through access charges. Thus, concludes AT&T, the composite tax factor

recovers "the costs of the two taxes it was designed to collect."[14] AT&T also maintains that its interstate rates reflect the differences in cash flows and the time value of money. It represents that this is not affected by the implementation of the gross receipts tax surcharge.

11. In its reply brief, COCC essentially reiterates arguments previously advanced. It maintains that AT&T has failed to sustain its burden of proving that the surcharge is not unreasonably discriminatory. It asserts that requiring Connecticut customers to pay a portion of other states' taxes as well as all of Connecticut gross receipts tax is not the "neutral, rational" policy that AT&T claims the GRTS supports. It disputes AT&T's contention that Connecticut is a "High-Cost" state.[15] It

argues that "AT&T has failed to provide the basic cost data required of a carrier which wishes to support discriminatory treatment of like services through a policy rather than cost-of-service analysis."[16] In addition, COCC defends the Connecticut tax on "a seller's gross receipts" as opposed to an excise tax on "a customer's usage," such as the one imposed by the State of Illinois. Finally COCC argues that state government flow-throughs of municipal taxes are irrelevant to the issues here because states are not bound by the "anti-discriminatory prohibitions of the Federal Communications Act." Reply Brief at 30.

II. DISCUSSION

12. We have reviewed the record in this proceeding and find no support for complainants' contention that the gross receipts tax surcharge collected in Connecticut by AT&T subjects Connecticut customers to unjust or unreasonable discrimination. There is no dispute that the interstate service provided to customers in Connecticut and the service provided to customers residing in other states are "like" services. There is also no dispute that customers in the ten states which impose a gross receipts tax on interstate telecommunications pay more than customers of the states which do not impose either a gross receipts tax or an excise tax on telecommunications.[17] However, the Communications Act does not bar all rate discrimination, only "unjust

or unreasonable" discrimination. 47 U.S.C. § 202(a). We find that the gross receipts tax surcharge collected by AT&T in Connecticut is just and reasonable.

13. The Common Carrier Bureau observed in the May 30 AT&T Order, and we agreed in our Review Order, that the flow-through represents the allocation of specific costs directly to the originator of those costs; therefore, the flow-through itself is unlikely to be discriminatory. We stated that we would consider allegations in a complaint proceeding as to the discriminatory or otherwise unlawful effects of retaining other types of taxes in AT&T's nationwide averaged rates. Review Order at 550. COCC has made no such assertions. On the contrary, COCC would have us conclude that all taxes should be included in AT&T's averaged rates. COCC argues that

it is unreasonable to flow-through one type of expense while pooling others, that the GRTS effectively deaverages rates for selective costs, and that, as a "low-cost" state, Connecticut already over-contributes its share of AT&T's costs in the form of averaged rates.

14. We have found that averaged national rates are in the public interest. See, e.g., MTS and WATS Market Structure, Recommended Decision and Order, CC Docket Nos. 78-72 and 80-286, 2 FCC Rcd 2324 (1987), Report and Order, 2 FCC Rcd 2953 (1987). Even if expenses are higher in some states than in others, averaging them furthers the public policy of encouraging affordable nationwide telephone service. See 47 U.S.C. § 151. Therefore, we agree with AT&T that whether Connecticut is a "Low-Cost" or "High-Cost" state is irrelevant to our

determination of the reasonableness of AT&T's surcharge.

15. The question to be decided in this proceeding is whether the surcharge is a just and reasonable method for AT&T to recover a state-specific gross receipts tax expense. The issue turns on whether it is proper for AT&T to flow through the costs associated with the Connecticut gross receipts tax or whether AT&T is constrained to continue to keep those costs in the expense pool which forms the basis for AT&T's nationwide averaged rates. Thus, the question before us in this complaint is not whether other costs are properly included in the expense pool, but whether the Connecticut gross receipts tax may be properly excluded. We believe that it may. As we stated in the Review Order, this flow-through represents the allocation of specific

costs directly to the originator of those costs.

16. The gross receipts tax at issue in this proceeding is a tax which singles out a particular target, in this case interstate telecommunications. AT&T has not questioned Connecticut's right to enact such a tax scheme, which places the tax burden on the seller, AT&T, rather than on the end use.[18] What AT&T's gross receipts tax surcharge brings into question, however, is who should ultimately pay this extra burden which Connecticut has decided to levy on interstate telecommunications. AT&T's customers in Connecticut, who receive the benefit of the tax, or AT&T's customers nationwide. We find that it is not improper for AT&T to recover this cost only from Connecticut residents. We agree with AT&T that, were AT&T not to

flow through the gross receipts tax, states would have an incentive to target telecommunications carriers for special tax burdens and thereby export the cost of the tax to customers in other states, who do not directly benefit from, and who do not have the ability to influence the imposition of, this tax. Accordingly, we find that it is neither unjust nor unreasonable to pool taxes of general applicability, along with other expenses, in determining nationwide averaged rates, but to exclude gross receipts taxes.[19]

17. Nor do we agree with COCC's contention that AT&T's treatment of the gross receipts tax creates geographical deaveraged rates for selective costs. To the contrary, we agree with AT&T, and nothing in the record persuades us otherwise, that flowing through this tax does more to prevent destabilization of

averaged rates by maintaining the integrity of the averaging process.[20] By limiting a state's ability and incentive to shift its tax burden to customers in other states through the averaging process, the flow-through reduces pressures to deaverage rates to reflect state-specific costs. Disaggregating gross receipts taxes is consistent with the treatment afforded local gross receipts taxes by various jurisdictions, and complainants have presented no evidence that it has led to any general intrastate deaveraging.

18. For the reasons stated above, we find that any rate discrimination caused by AT&T's gross receipts tax surcharge is not unjust or unreasonable discrimination. COCC misapprehends Commission standards for evaluating whether discrimination is unjust or

unreasonable. The basis for determining if rates are unjustly discriminatory is not necessarily reliant upon a cost of service analysis. COCC's reliance on American Television Relay, 63 FCC 2d 911, 929 (1977) (ATR), to support its position that "AT&T has failed to present the FCC with a record of the basic cost analysis required by law before considerations of non-cost factors may be initiated" is misplaced. Reply Brief at 14. The issue in that case was the use of population in the rate structure. Whereas population is a "non-cost" consideration, and thus required the submission of cost data to guide the Commission in its determination, the gross receipts tax surcharge is already cost-based, the amount of Connecticut's gross receipts tax. No further basic cost analysis is required to support our policy

determination that this gross receipts tax surcharge is in the public interest and furthers the intent of the Communications Act.

19. COCC also is incorrect in its procedural argument that the burden shifts to AT&T to justify any discrimination, once there is a finding that the service in question is a "like" service. In a complaint proceeding, the complainant has the burden of proof. This burden does not shift to the defendant once the complainant has proved that the services are like. The cases cited by COCC are inapposite. For example, Western Union International, Inc. v. FCC and AT&T, 568 F.2d 1012 (2d Cir. 1977), was an appeal by international record carriers (IRCs) of a series of Commission decisions and orders in which the Commission determined, inter

alia, that services provided to the IRCs were "essentially identical" to those provided to domestic carriers, found that the existing disparate rate structure was discriminatory, and ordered AT&T to eliminate the disparity. The court stated that "once the FCC demonstrated a basis for its determination of likeness, the burden shifted to the IRCs to disprove the discrimination in their favor." Id. at 1018-19. However, this was not a complaint proceeding, and the IRCs were not defendants. Moreover, one of the cases quoted by COCC to buttress its position clearly states that it is the burden of proceeding which shifts to the defendant after the complainant has established a prima facie case and not the burden of proof. In the Matter of Referral of Questions from General Communications Incorporated v. Alascom,

Inc., 3 FCC Rcd 700, 705 (1988). AT&T has met its burden of going forward and developing a record to support its position that its GRTS is not unjust or unreasonable.

20. Finally, COCC has presented no evidence to support its assertion that AT&T computes the gross receipts tax surcharge incorrectly. First, COCC appears to have made its calculations based on the 7.33 percent rate AT&T was charging until July 1, 1988. At that time the rate dropped to 6.77 percent. As AT&T explained, it recalculates the figure each year, and any overcharge one year will result in a reduction the next year. Second, AT&T deducts the access charges it pays the LECs before it applies the GRTS rate.[21] Therefore, it does not receive a double recovery for access charges. Nor does it overcharge

by failing to take into account the time value of money, in this case the lag between the collection of the surcharge and the payment of the tax to Connecticut. In the May 30 AT&T Order, the Bureau considered whether AT&T would receive a windfall since it would accumulate revenues from the flow-through during the year, but would not have to pay its tax bill to the state until the following year. We agree with the Bureau that "the recovery of this cost is no different than any other for which the recovery of the cost does not necessarily coincide with the payment of the expense." Id. at ¶ 57. AT&T's interstate rates already reflect its working capital requirements, which in turn reflect differences in cash flows and the time value of money.

21. For the reasons discussed above,

we find that the gross receipts tax surcharge provision in AT&T's interstate tariffs as applied to Connecticut ratepayers is not unjustly nor unreasonably discriminatory.

III. PROCEDURAL ISSUES

22. Finally, we address complainants' request for a hearing and the motion for a procedural order establishing a hearing and discovery schedule. AT&T opposed the motion. However, after conferences with Commission staff, complainants submitted and AT&T responded to interrogatories. Therefore, the request for a discovery schedule is moot. As to the hearing issues, complainants argue that a hearing before an administrative law judge (ALJ) is necessary to permit them to present a

full record of the basis for the discrimination, to protect the due process rights of complainants, and to ensure a fair disposition of the complaint. In opposition, AT&T cites various Commission decisions which indicate that formal complaints are ordinarily resolved on the basis of the written pleadings.

23. The Commission has discretion to resolve Section 208 complaint proceedings, 47 U.S.C. § 208, on the evidence of record without the need to resort to time-consuming and costly full evidentiary proceedings before ALJ's unless it determines a hearing is needed to resolve disputed questions of a fact. See, e.g., Comark Cable Fund III, d/b/a CCI Cablevision v. Northwestern Indiana Telephone Company, Inc., 104 FCC 2d 451 (1985), remanded for clarification sub

nom. Northwestern Indiana Telephone Company v. FCC, 824 F.2d 1205 (D.C. Cir. 1987), clarified on remand, 3 FCC Rcd 3096 (1988), petition for review denied, Northwestern Indiana Telephone Co. v. FCC, 872 F.2d 465 (D.C. Cir. 1989), petitions for rehearing and for rehearing en banc denied (D.C. Cir. June 17, 1989). As we have stated above, the facts complainants allege to be in controversy are simply not germane to the outcome of this proceeding. Thus, there are no disputed questions of fact which might necessitate that this matter be set down before an Administrative Law Judge. The complainants have been granted ample opportunity to develop evidence in this matter, including discovery, and all hearing requirements contemplated by Section 208 have thus been satisfied. Therefore, we deny the request to

establish a separate hearing schedule before an ALJ.

IV. ORDERING CLAUSES

24. Accordingly, IT IS ORDERED that the motion for a procedural order establishing a hearing and discovery schedule IS DENIED.

25. IT IS FURTHER ORDERED that the complaint against AT&T Communications filed by COCC on March 18, 1988, IS DENIED.

FEDERAL COMMUNICATIONS COMMISSION

Donna R. Searcy
Secretary

FOOTNOTES

[1]Formerly the Connecticut Division of Consumer Counsel.

[2]Ten states currently impose a gross receipts tax on telecommunications.

[3]Complaint at 5.

[4]Brief at n.17, citing AT&T, Revisions of Tariff FCC No. 260, Docket No. 18128, 61 FCC 2d 587, 656 (1976).

[5]Connecticut obtained this figure from AT&T's Answer dated May 11, 1988.

[6]AT&T's Opposition to Direct Case of Connecticut (Opposition) at 2.

[7]NARUC v. FCC, 737 F.2d 1095, 1133 (D.C. Cir. 1984), cert. denied, 469 U.S. 1227 (1985).

[8]Opposition at 9, quoting from AT&T, 70 FCC 2d 593, 613 (1978).

[9]Opposition at 17.

[10]Opposition at 19.

[11]Opposition at 11-12 and cases cited therein.

[12]AT&T states that COCC has incorrectly mistated this as 7.33%. The surcharge was reduced to 6.77% as of July 1, 1988. AT&T recalculates the figure each year based on demand estimates, and any overcollection one year results in a reduction for the next year. Opposition at 27.

[13]Opposition at 26, which refers to Southern New England Telephone Company's 1988 Access Charge Tariff Filing.

[14]Opposition at 29.

[15]Reply Brief at 12.

[16]Reply Brief at v.

[17]The record indicates that eleven states impose sales or excise taxes on interstate telecommunications services. Customers in those states pay this tax in addition to AT&T's basis charge for interstate service.

[18]COCC cites Goldberg v. Sweet, 488 U.S., 109 S.Ct. 582 (1989) (Goldberg) (upholding the Illinois telecommunications excise tax) for the

proposition that, because taxing AT&T directly is justifiable, passing the tax through only to Connecticut customers is discriminatory. Reply Brief at 25. There is nothing in Goldberg to support this conclusion. The nexus for Connecticut to impose a gross receipts tax on AT&T is not at issue here. The question is, when AT&T seeks to recover the expense of this tax from its customers, should it recover the tax expense from its customers nationwide or only from its Connecticut customers. Goldberg does not even remotely touch upon that issue.

[19]Apparently Connecticut considered amending its gross receipts tax in 1986, but did not do so, at least partially because "chang[ing] from a gross earnings tax to an excise tax on interstate

telecommunications will always raise [Connecticut] customer' [sic] bills," and an excise tax is seen by customers on their bills, but a gross receipts tax is "hidden." AT&T's Opposition at 4-5, quoting from Fiance, Revenue and Bonding Committee, Connecticut General Assembly, Final Report of the Connecticut Telecommunications Task Force (1986). Apparently, the future applicability of our decision is somewhat limited since the record reflects that Connecticut has recently enacted legislation which eliminates the gross receipts tax on interstate telecommunications, effective January 1, 1990. It is one of five states which have repealed or reduced the gross receipts tax since AT&T instituted the gross receipts tax surcharge. Letter from David Carpenter, Attorney for AT&T Communications, to Secretary, FCC (July 31, 1989).

[20]See also, May 30 AT&T Order at 956 ("... the imposition of gross receipts taxes upon interstate services has a far more de-stabilizing impact on nationally averaged rates than does AT&T's attempt herein to ensure that only those who benefit from the tax will pay the tax").

[21]For example, to obtain the 6.77% tax factor, AT&T first calculated the 6.5% Connecticut gross receipts tax rate on 1987 billed revenues less deductions (including switched access charges) to obtain an effective tax rate on billed revenues of 3.35%. Then, using the statutory rate of 9.0% on interstate switched access, it computed the amount of its access expense which was attributable to the gross receipts tax on local exchange carriers. It calculated that this was 3.42% of estimated 1988

billed revenues. Adding these two factors, 3.35% plus 3.42%, resulted in the current composite tax factor of 6.77%. See Opposition. Affidavit of Louis Ambrose, Attachment A, for the specific numbers used in the calculation.

APPENDIX

§ 208. Complaints to Commission; investigations; duration of investigation; appeal of order concluding investigation

(a) Any person, any body politic or municipal organization, or State commission, complaining of anything done or omitted to be done by any common carrier subject to this chapter, in contravention of the provisions thereof, may apply to said Commission by petition which shall briefly state the facts, whereupon a statement of the complaint thus made shall be forwarded by the Commission to such common carrier, who shall be called upon to satisfy the complaint or to answer the same in writing within a reasonable time to be specified by the Commission. If such common carrier within the time specified

shall make reparation for the injury alleged to have been caused, the common carrier shall be relieved of liability to the complainant only for the particular violation of law thus complained of. If such carrier or carriers shall not satisfy the complaint within the time specified or there shall appear to be any reasonable ground for investigating said complaint, it shall be the duty of the Commission to investigate the matters complained of in such manner and by such means as it shall deem proper. No complaint shall at any time be dismissed because of the absence of direct damage to the complainant.

(2)

No. 90-1008

In the Supreme Court of the United States

OCTOBER TERM, 1990

CONNECTICUT OFFICE OF CONSUMER COUNSEL, ET AL.,
PETITIONERS

v.

FEDERAL COMMUNICATIONS COMMISSION, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

BRIEF FOR THE FEDERAL RESPONDENTS IN OPPOSITION

KENNETH W. STARR
Solicitor General
Department of Justice
Washington, D.C. 20530
(202) 514-2217

ROBERT L. PETTIT
General Counsel
JOHN E. INGLE
Deputy Associate General Counsel
LAURENCE N. BOURNE
Counsel
Federal Communications Commission
Washington, D.C. 20554

QUESTIONS PRESENTED

1. Whether the Federal Communications Commission acted arbitrarily and capriciously in finding that a gross receipts tax flow-through, which passed on to Connecticut ratepayers the costs of that State's narrowly targeted gross receipts tax on interstate telecommunications, was not unreasonably discriminatory.

2. Whether the Federal Communications Commission abused its discretion in rejecting petitioners' request for a trial-type hearing and deciding the complaint on the basis of a record that included discovery, written testimony, and briefs.

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases:

Cases—Continued: Page

Statutes:

In the Supreme Court of the United States

OCTOBER TERM, 1990

No. 90-1008

CONNECTICUT OFFICE OF CONSUMER COUNSEL, ET AL., PETITIONERS

v.

FEDERAL COMMUNICATIONS COMMISSION, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE FEDERAL RESPONDENTS IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals is reported at 915 F.2d 75 (Pet. App. la-14a). The order of the Federal Communications Commission is reported at 4 FCC Rcd 8130 (Pet. App. 15a-55a).

JURISDICTION

The judgment of the court of appeals was entered on September 20, 1990. The petition for a writ of certiorari was filed on December 18, 1990. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

Petitioners filed a petition for review in the court of appeals challenging the Federal Communications Commission's (FCC's) determination that American Telephone and Telegraph Company (AT&T) could impose the costs of Connecticut's narrowly targeted telecommunications gross receipts tax directly on Connecticut ratepayers. The court of appeals denied the petition, concluding that the FCC properly prevented Connecticut from exporting the burden of that tax to out-of-state ratepayers through nationwide averaged rates. Pet. App. 1a-14a.

1. The Communications Act of 1934 (as amended), 47 U.S.C. 151 *et seq.*, places the primary responsibility for setting telephone rates on the carriers themselves, who initiate rate changes by filing tariffs with the FCC. 47 U.S.C. 203. See generally *New England Telephone & Telegraph Co.* v. *FCC*, 826 F.2d 1101, 1104 (D.C. Cir. 1987), cert. denied, 490 U.S. 1039 (1989). Those rates must be "just and reasonable," 47 U.S.C. 201(b), and free of "any unjust or unreasonable discrimination," 47 U.S.C. 202(a). The FCC may reject a tariff if it is unlawful on its face. See *Associated Press* v. *FCC*, 448 F.2d 1095, 1103 (D.C. Cir. 1971).[1] In addition, any person who is injured by a communications common carrier may file a complaint with the FCC, 47 U.S.C. 207 and 208, which has the discretion to investigate the matters complained of "in such manner and by such means as it shall deem proper." 47 U.S.C. 208. The FCC

---

[1] The FCC may also investigate legally suspect rates that are not patently unlawful and, pending a hearing, may suspend the effectiveness of those rates for up to five months. 47 U.S.C. 204(a). See *American Telephone & Telegraph Co.* v. *FCC*, 487 F.2d 865, 871 (2d Cir. 1973). If the investigation is not completed within that time, the proposed rates become effective by operation of law, but the FCC may order refunds of amounts ultimately found to be unjustified. 47 U.S.C. 204(a).

may award monetary damages to the complainant if the complainant is entitled to damages. 47 U.S.C. 209.

2. The rates for interstate long-distance telephone calls are generally determined on the basis of the long-distance company's costs of providing the telephone service.[2] Traditionally, long-distance companies, such as AT&T, have averaged their interstate costs over the nation to produce a system of uniform, nationwide averaged rates. Under that system, users in high cost areas pay approximately the same charges as users in low cost areas for calls having similar characteristics of distance and duration. Nationwide averaged rates generally reflect, among other things, an average of the interstate access charges assessed by the various local telephone companies and an average of the property, corporate income, and other generally applicable taxes assessed against the carrier by the various states. See Pet. App. 4a-5a.

During the mid-1980s, several States, including Connecticut, targeted telecommunications for special taxes on the carrier's gross receipts. AT&T recognized that if those gross receipts taxes were subject to the normal interstate rate averaging process, the burden they impose would be exported to residents of other States through higher averaged telecommunications rates. AT&T therefore filed tariff revisions designed to pass through these narrowly targeted taxes

---

[2] All long-distance calls require the use of both local telephone plant and long-distance facilities. A typical long-distance call begins on an individual subscriber's local loop, travels through local switches to long-distance lines, and ultimately returns to another local system where the recipient of the call resides or does business. Since the breakup of the unified Bell System, the provision of interstate long-distance service has required the interstate activities of both long-distance (or interexchange) carriers, such as AT&T, and local telephone companies, which provide the "access" that connects the long-distance facilities to local subscribers. See generally *National Ass'n of Regulatory Util. Comm'rs (NARUC)* v. *FCC*, 737 F.2d 1095, 1105 (D.C. Cir. 1984), cert. denied, 469 U.S. 1227 (1985).

(through a gross receipts tax surcharge) to the consumers in the States that assessed them. The FCC denied various petitions to suspend or reject those filings, and the First Circuit subsequently dismissed challenges to the FCC's action, finding that the FCC's determination not to suspend the tariff was not a final reviewable order. *Maine Public Advocate* v. *FCC*, 828 F.2d 68, 69 (1st Cir. 1987). Pet. App. 5a-6a.

In March 1988, petitioners Connecticut Office of Consumer Counsel, *et al.*, filed a complaint with the FCC alleging that AT&T's flow-through provision was unjust, unreasonable and unreasonably discriminatory under Sections 201(b) and 202(a) of the Communications Act. Petitioners also asserted that, even if AT&T could permissibly flow through gross receipts taxes in principle, the carrier's method of calculating the flow-through over-collected the cost of those taxes. They requested the FCC to restrain future enforcement of the flow-through provision in Connecticut and to order AT&T to refund to Connecticut ratepayers all sums collected under that provision. Petitioners also moved for an evidentiary hearing on their complaint. Pet. App. 6a-7a.

The FCC dismissed petitioners' complaint, concluding that the flow-through did not result in "unjust or unreasonable" discrimination. Pet. App. 15a-55a. The FCC acknowledged that ratepayers in States subject to the flow-through provision would pay more for AT&T long-distance service than those in States with generally applicable taxes that are pooled, but explained:

> [W]ere AT&T not to flow through the gross receipts tax, states would have an incentive to target telecommunications carriers for special tax burdens and thereby export the cost of the tax [through the averaging process] to customers in other states, * * * who do not directly benefit from, and do not have the ability to

> influence the imposition of, this tax. Accordingly, we find that it is neither unjust nor unreasonable to pool taxes of general applicability, along with other expenses, in determining nationwide averaged rates, but to exclude gross receipts taxes.

Id. at 37a-38a. The FCC also rejected petitioners' claim that AT&T's methodology for calculating the gross receipts tax flow-through over-collected the costs of that tax. *Id.* at 43a-44a. Finally, the FCC denied petitioners' request for an evidentiary hearing. *Id.* at 45a-48a. The agency concluded that there were no material disputed facts that would justify time-consuming and costly evidentiary hearings, noting that petitioners had been given "ample opportunity to develop evidence in this matter, including discovery," and that petitioners' factual allegations were "not germane to the outcome of this proceeding." *Id.* at 46a-47a.

3. The court of appeals denied petitioners' petition for review, finding the FCC's action to be "well within its broad authority." Pet. App. 7a, 10a. The court noted at the outset that the Communications Act "does not require equal rates for all customers. Rather, it requires only that rate differentials between customers for like service be 'just and reasonable.'" *Id.* at 10a. Nationwide rate averaging, the court reasoned, "is thus not compelled by the statute but has been adopted by the Commission as a means of ensuring that basic telecommunications services are available nationwide and will not be foreclosed in areas where fixed costs tend to be high relative to use." *Ibid.* The gross receipts tax flow-through, the court found, was a reasonable exception to this general policy, and, in fact, operated to protect the averaging process from manipulation. *Ibid.*

The court found "unassailable" the FCC's conclusion that without a gross receipts tax flow-through, "states would have an incentive to target telecommunications companies as sources of revenue, with the bulk of the tax incidence

ultimately falling on out-of-state residents through nation-wide averaging." Pet. App. 10a-11a. Indeed, the court noted, "the record suggests that the prospect of this windfall influenced Connecticut's retention of the gross receipts tax over alternate forms of taxation." *Id.* at 11a.[3] The court distinguished gross receipts taxes from other state assessments that AT&T customarily pooled. The court noted, for instance, that "property and income taxes are broad-based, and their burdens fall for the most part on residents who are represented in the state's political process." *Id.* at 11a-12a. Unlike the gross receipts tax at issue here, such taxes "do not single out an industry that must average its fixed costs nation-wide by regulatory order and therefore do not offer an opportunity to transfer the burden of the tax to non-residents." *Id.* at 12a. Thus, the court concluded, "while a pass-through mechanism is necessary in the case of a gross receipts tax, it is not needed for these other types of taxes." *Ibid.*

The court of appeals also rejected petitioners' claim that AT&T's formula for calculating the flow-through over-collected the costs to AT&T attributable to the gross receipts tax. Pet. App. 13a-14a. Like the FCC, the court found that the flow-through was designed to recover no more than the actual tax costs AT&T incurred—both directly from the tax on AT&T's revenues, exclusive of access costs, and indirectly from the "portion of access charges paid that were at-

---

[3] The court observed that in the absence of a gross receipts tax flow-through, "the success of a few states in exporting their tax burden via interstate rates would cause other states to impose their own gross receipts taxes in response" and lead to "an upward-spiraling of interstate telephone rates to a level bearing no relation to actual costs of service." Pet. App. 11a. "Nipping that prospect in the bud," the court found, "is well within the Commission's mandate 'to make available . . . a rapid, efficient, Nation-wide . . . communication service with adequate facilities at reasonable charges.'" *Ibid.*, quoting 47 U.S.C. 151.

tributable to the tax on local exchange carriers' access charge revenues." *Id.* at 14a. With respect to the latter component of the flow-through, the court found that petitioners offered "no reason * * * to believe that the tax on local carriers' access charge revenue was not passed along to AT&T." *Ibid.*

Finally, the court rejected petitioners' assertion that the FCC erred in denying its request for an evidentiary hearing. Having previously noted that the proceeding before the agency had included discovery, written testimony and briefs, Pet. App. 7a, the court found that there "were no relevant factual issues in controversy and no need for a factual hearing." *Id.* at 14a.

ARGUMENT

The court of appeals correctly concluded that AT&T's gross receipts tax flow-through tariff was not unjustly or unreasonably discriminatory to Connecticut consumers. That ruling does not conflict with any decision of this Court or another court of appeals. Moreover, Connecticut has repealed its gross receipts tax effective January 1, 1990, and the issue thus has limited continuing significance. The court of appeals also correctly affirmed the FCC's conclusion that no pertinent issue of disputed fact existed that would require an evidentiary hearing. Petitioners' continued insistence that the agency abused its discretion in this case by deciding the case on written submissions does not merit further review.

1. Petitioners assert that the court of appeals erred in failing to reverse, as arbitrary and capricious, the FCC's ruling that AT&T's gross receipts tax flow-through did not unreasonably discriminate against Connecticut ratepayers. Pet. 21-37. In particular, petitioners complain that the court's decision "is not supported on the record and is con-

trary to significant ratepayer and consumer interests." *Id.* at 21. As the court of appeals noted, however, the FCC has "broad discretion" in carrying out its ratemaking functions. Pet. App. 8a, citing *Permian Basin Area Rate Cases*, 390 U.S. 747, 800 (1968); *Federal Power Comm'n* v. *Hope Natural Gas Co.*, 320 U.S. 591, 602 (1944). Petitioners' challenge to the court of appeals' application of this appropriately deferential standard is not a matter warranting this Court's further review.

In any event, the court of appeals' conclusion that the FCC acted "well within its broad authority," Pet. App. 10a, is correct and is consistent with recent decisions of the District of Columbia and Ninth Circuits, which have held that a " 'neutral, rational basis underlying apparently disparate charges' * * * precludes a finding that the rates are 'unreasonably' discriminatory." *American Telephone & Telegraph Co.* v. *FCC*, 832 F.2d 1285, 1293 (D.C. Cir. 1987), quoting *NARUC* v. *FCC*, 737 F.2d at 1133; accord *Reservation Telephone Coop.* v. *FCC*, 826 F.2d 1129, 1136 (D.C. Cir. 1987); *Air Transp. Ass'n of America* v. *Public Util. Comm'n*, 833 F.2d 200, 206 (9th Cir. 1987).

As we have explained, the court of appeals sustained the FCC's action as a "reasonable exception" to its policy favoring nationwide rate averaging "because without [the flow-through], states would have an incentive to target telecommunications companies as sources of revenue, with the bulk of the tax incidence ultimately falling on out-of-state residents through nationwide averaging." Pet. App. 10a. "The result would be an upward-spiraling of interstate telephone rates to a level bearing no relation to actual costs of service." *Id.* at 11a. Thus, the flow-through in fact served to protect the integrity of the averaging process and the statutory goal of universal service that process was designed to promote. *Ibid.* See also *NARUC* v. *FCC*, 737 F.2d at 1108; *United States* v. *Western Elec. Co.*, 569 F. Supp. 1057,

1120 (D.D.C. 1983) (stressing importance of the public's interest in universal service). As such, the flow-through was not unreasonably discriminatory.

None of petitioners' renewed attacks on the FCC's analysis bears scrutiny. Petitioners claim, for instance, that all state taxes export tax burdens to non-residents, and thus avoiding such exportation does not provide a basis to distinguish gross receipts taxes from other state assessments. Pet. 25. As the court of appeals recognized, however, this claim misses the point of the FCC's analysis. While nationwide rate averaging exports from every State a portion of the carrier's state-specific costs of business (while importing a portion of such costs from every other State), broad-based state taxes, such as property and income taxes, "fall for the most part on residents who are represented in the state's political process." Pet. App. 11a-12a.

Gross receipts taxes, on the other hand, create a "political and financial windfall" for the taxing State by narrowly targeting industries, like telecommunications, which must average costs nationwide by regulatory order. Pet. App. 11a. Most of the burden of such taxes falls, through the averaging process, on nonresidents. Although petitioners belittle this distinction between narrow- and broad-based taxes in their petition, the record below indicates that the Connecticut legislature clearly recognized and sought to capitalize on the distinction in selecting the gross receipts tax over alternative revenue sources. *Id.* at 11a, 52a-53a n.19.[4]

---

[4] Petitioners rely heavily (Pet. 26-31) on *City of Montrose* v. *Public Util. Comm'n*, 197 Colo. 119, 590 P.2d 502 (1979), for a different result. That case, however, simply reflects one State's construction of the requirements of its public utilities statute and would not bear directly on the lawfulness of the FCC's action under the Communications Act. In any event, the circumstances presented in *Montrose* and this case are not analogous. The regulatory order implementing the municipal franchise fee flow-through in *Montrose* had been adopted "solely as

Petitioners are also mistaken in claiming that a cost-of-service study was necessary to assess the reasonableness of AT&T's gross receipts tax flow-through. Pet. 27-32. The FCC and the court of appeals correctly found that AT&T's aggregate costs in Connecticut, relative to other States, were irrelevant to the question whether the species of cost at issue here—gross receipts taxes—should be pooled. Pet. App. 12a, 38a-41a. In fact, because rate averaging, by definition, results in above-cost rates in some States and below-cost rates in others, linking the validity of the flow-through to AT&T's relative state-by-state cost levels would be inconsistent with the rate averaging principle petitioners purport to support. *Id.* at 12a.[5]

2. Connecticut's repeal of its gross receipts tax, Pet. 19-20, has eliminated any warrant for further review of the court of appeals' decision. Injunctive relief against applica-

---

a matter of administrative convenience," 147 Colo. at 123, 590 P.2d at 506, and without reference to universal service concerns of the type that the FCC properly considered under the Communications Act.

[5] Petitioners' additional contentions that no consumer groups have supported the flow-through (Pet. 24-25), and that the Connecticut tax long pre-dated the flow-through without having an adverse impact on nationwide rates (*id.* at 32-33), are of no significance. Including the costs of Connecticut's gross receipts taxes in AT&T's nationwide cost pool would, as a matter of mathematical certainty, increase nationwide averaged rates. The fact that such costs previously were distributed so widely that no consumer group found it worthwhile to challenge them is simply irrelevant to the FCC's "unassailable" analysis. Pet. App. 11a. Petitioners' suggestion that the FCC should have determined the lawfulness of Connecticut's tax, rather than approving AT&T's flow-through (Pet. 34), is plainly without merit. Section 208 of the Communications Act provides an avenue for resolving complaints against "common carriers" for actions taken "in contravention of the [Communications Act]." 47 U.S.C. 208. Whatever might be said of the lawfulness of Connecticut's gross receipts tax, that question was beyond the legitimate scope of this administrative proceeding, which properly was confined to questions regarding the lawfulness of AT&T's tariff.

tion of the flow-through in that State is clearly moot, and even if petitioners prevailed on the merits, any reparations to petitioners would likely be limited to damages the state agencies incurred in their proprietary capacities. Pet. App. 8a n.1. See, *e.g.*, *Hawaii* v. *Standard Oil Co.*, 405 U.S. 251, 257-266 (1972) (denying a State standing, as *parens patriae*, to seek damages under Section 4 of the Clayton Act). Moreover, because several other States have repealed their gross receipts taxes, Pet. App. 52a-53a n.19, and the few remaining States with such taxes have chosen not to challenge AT&T's flow-through, petitioners' challenge is unlikely to bear seriously upon any broader current or future interests.

3. Petitioners' contention that the denial of their request for an evidentiary hearing "constitutes an abuse of discretion under the circumstances of [this] case" (Pet. 37) does not present an issue warranting this Court's review. First, Section 208 of the Communications Act does not mandate evidentiary hearings on complaints. Rather, it gives the FCC broad discretion to investigate complaints "in such manner and by such means as it shall deem proper." 47 U.S.C. 208. In the absence of constitutional due process concerns, which the petitioners do not assert, reviewing courts generally are not free to impose procedural rights where Congress has chosen not to require them. See *Vermont Yankee Nuclear Power Corp.* v. *Natural Resources Defense Council, Inc.*, 435 U.S. 519, 524 (1978).

Moreover, the FCC's established policy has been to reserve evidentiary hearings for those cases in which disputed issues of material fact make oral testimony essential to resolving the case. See Pet. App. 46a-47a. The FCC's denial of petitioners' request for an evidentiary hearing here was a straightforward application of that policy; the only facts alleged to be in controversy were "not germane to the outcome of this proceeding." *Id.* at 47a. Petitioners' continued

insistence that factual issues remained as to AT&T's cost of service in Connecticut brushes past the FCC's analysis, which approved the flow-through of one category of costs—gross receipts taxes—regardless of the relative state-by-state levels of other costs. The court of appeals properly affirmed that analysis and correctly concluded that the FCC did not abuse its discretion in declining to hold an evidentiary hearing. *Id.* at 39a-40a.[6]

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

KENNETH W. STARR
Solicitor General

ROBERT L. PETTIT
General Counsel

JOHN E. INGLE
Deputy Associate General Counsel

LAURENCE N. BOURNE
Counsel
Federal Communications Commission

FEBRUARY 1991

---

[6] Petitioners' suggestion (Pet. 18, 38) that a trial-type hearing was required to determine whether AT&T correctly calculated the flow-through is incorrect. Petitioners' principal challenge to AT&T's calculations was methodological, see Pet. App. 14a, making it well suited to resolution on the basis of written submissions. And as the court of appeals found, despite discovery, written testimony and briefs, the State otherwise offered "no reason" to believe that AT&T's flow-through calculations contained any errors. *Ibid.*

☆ U.S. GOVERNMENT PRINTING OFFICE: 1991—282-061/20406

(3)

No. 90-1008

IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

CONNECTICUT OFFICE OF CONSUMER COUNSEL, *et al.*,
Petitioners,

v.

FEDERAL COMMUNICATIONS COMMISSION, *et al.*,
Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Second Circuit

---

AT&T's OPPOSITION TO PETITION FOR CERTIORARI

FRANCINE J. BERRY
DAVID P. CONDIT
295 North Maple Avenue
Basking Ridge, NJ 07920
(908) 221-2000

DAVID W. CARPENTER *
PETER D. KEISLER
SIDLEY & AUSTIN
One First National Plaza
Chicago, IL 60603
(312) 853-7000
Counsel for Respondent American Telephone and Telegraph Company

* *Counsel of Record*

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

QUESTION PRESENTED

Whether the Federal Communications Commission acted arbitrarily and capriciously in concluding that AT&T did not engage in unreasonable discrimination in violation of 47 U.S.C. § 202(a) by adopting a tariff that recovers the costs imposed by state gross receipts taxes from the ratepayers in the states imposing the tax, and that thereby equalizes the burdens under similar taxes and eliminates the incentive of states to adopt taxes that artificially increase rates for interstate telecommunications service.

STATEMENT REQUIRED BY RULE 29.1

American Telephone and Telegraph Company ("AT&T") has no parent company. In addition to its wholly-owned subsidiaries, AT&T has ownership interests, either directly or through wholly-owned subsidiaries, in ACE Limited; Paradigm Technology, Inc.; Sundisk Corporation; Resound Corporation; Intermetrics Inc.; Telehouse America, Inc.; Communications Software Development, Inc. (Mitek Systems, Inc.); Compagnie Industriali Riunite S.p.A. (CIR); Sun MicroSystems, Inc.; Societa' Italiana Telecommunicazioni S.p.A. (Italtel); Canadian Distance Learning Development Centre Ltd.; Truevision, Inc.; Atesia S.p.A.; Jamaica Digiport International, Ltd.; Omnicad; Novo Quality Services Pte. Ltd. (Singapore); Western Electric Saudi Arabia, Ltd. (WESA); GoldStar Information and Communications Co. Ltd.; Airways Facilities Engineering Co.; AG Communications Systems Corporation; APT Italia S.A.; CA Charlotte Associates; Grassmere Park Associates; 155334 Canada Inc. (Canada); Tower Center Associates; ABC Travelbank Limited; AT&T Credit FSC, Inc.; AT&T Fleet Services; AT&T JENS Corporation (Japan); AT&T of Shanghai, Ltd.; Call Interactive; Cuban American Telephone and Telegraph Co. (Cuba); Facilities Management Services Limited; GoldStar Fiber Optics Co., Ltd. (Korea); PITS Holding BV; Rosewood Associates; AT&T ISTEL Purchasing Systems Limited; AT&T Network Systems Espana SA; AT&T Ricoh Company Ltd. (Japan); InView Limited; LITESPEC Inc.; LYCOM A/S (Denmark); Claimview Limited; ISTEL Holdings Limited; AT&T Taiwan Telecommunications Co., Ltd.; Failsafe ROC Limited; AT&T Network Systems International BV (Netherlands); Agricultural Commodities Services Limited; InView Holdings Limited; VIEWTEL Holdings Limited; AT&T Automotive Services, Inc.; AT&T Europe s.a./n.v. (Belgium); AT&T (UK) Ltd.; AT&T Telecommunicacoes Ltda. (Brazil); AT&T France S.A.; Eastern Telephone and Telegraph Company (Canada); and AT&T Hong Kong Limited.

TABLE OF CONTENTS

TABLE OF AUTHORITIES

CASES Page

TABLE OF AUTHORITIES—Continued

IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

No. 90-1008

CONNECTICUT OFFICE OF CONSUMER COUNSEL, *et al.*,
Petitioners,

v.

FEDERAL COMMUNICATIONS COMMISSION, *et al.*,
Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Second Circuit

---

AT&T's OPPOSITION TO PETITION FOR CERTIORARI

REASONS FOR DENYING THE WRIT

In this case, petitioners have challenged a provision in AT&T's interstate long-distance tariffs that recovers the costs of state gross receipts taxes from the customers in the particular state that imposes each tax. This provision ensures equal treatment of charges under similar taxes, and it eliminates the incentive states would otherwise have to export their tax burden to citizens in other states and thereby artificially inflate the cost of long-distance serv-

ice. On this basis, the Federal Communications Commission ("FCC") held that any rate differences that result from this surcharge do not constitute unreasonable discrimination in violation of Section 202(a) of the Communications Act, and the United States Court of Appeals for the Second Circuit upheld this decision.

There is no basis for this Court to review the decision of the Court of Appeals. That decision does not conflict with any decision of this Court or any other Court of Appeals. Rather, the Second Circuit's decision is simply an application of settled interpretations of Section 202(a) of the Communications Act to a set of unique facts. Indeed, petitioners' contention is that the judgment below "is not supported on the record and is contrary to significant ratepayer and consumer interests." Pet. 21. This claim would be inappropriate for Supreme Court review even if it had any substance. However, as explained below, the record abundantly supports the decisions of the FCC and the Court of Appeals.

1. AT&T's gross receipts tax surcharge ("GRTS") is a response to state laws that were enacted in the wake of fundamental changes in federal constitutional law in the mid-1970s. Prior to that time, the Constitution had been interpreted to prohibit state gross receipts taxes on interstate telecommunications services,[1] and few states have ever imposed such taxes. Instead, they have subjected interstate telecommunications carriers to income taxes, property taxes, and other like taxes that apply generally to businesses and individuals throughout the state. Because of their general applicability, the burden of these taxes falls almost entirely on the citizens in the state imposing them.

---

[1] *Compare New Jersey Bell Tel. Co.* v. *State Bd. of Taxes*, 280 U.S. 338 (1930); *Cooney* v. *Mountain States Tel. & Tel. Co.*, 294 U.S. 384 (1935); *Joseph* v. *Carter & Weekes Stevedoring Co.*, 330 U.S. 422, 432-34 (1947) *with Department of Revenue* v. *Association of Washington Stevedoring Cos.*, 435 U.S. 734 (1978), *and Complete Auto Transit, Inc.* v. *Brady*, 430 U.S. 274 (1977).

Several states have responded to the intervening change in federal constitutional law by imposing sales or excise taxes on the charges for interstate telecommunications services. These states have structured their taxes so that the tax is recovered directly from ratepayers within their jurisdictions through a separate charge on their citizens' interstate telephone bills. Thus, the economic burden of paying these taxes rests with their citizens alone. *See Goldberg* v. *Sweet*, 488 U.S. 252 (1989) (upholding Illinois Telecommunications Excise Tax on this ground).

However, as of March, 1986, nine states (including Connecticut) were imposing gross receipts taxes on interstate telecommunications carriers with no provision for recovery of this tax from their own citizens. Because AT&T did not then "flow through" these expenses to ratepayers in the states that imposed them, the expenses that resulted from these taxes were recovered by increasing AT&T's averaged nationwide rates. The net result was that the state that imposed the tax received the benefit of the tax, but its burden was almost entirely exported to customers in other states. This created a perverse incentive for states to target interstate telecommunications carriers for special tax burdens and thereby artificially raise the costs of interstate telecommunications services.

These perverse incentives are vividly illustrated by the legislative history of Connecticut's gross receipts tax. As the FCC and the Court of Appeals observed (Pet. App. 11a, 52a-53a), when Connecticut considered reforming its taxes in 1986, it decided to retain its gross receipts tax precisely because the tax burden would be exported to other states.[2]

---

[2] Connecticut candidly stated that, whereas an excise tax and a gross receipts tax would produce the same revenues, they would have vastly different consequences for Connecticut residents: an excise tax would increase each Connecticut resident's phone bill by the amount of the tax, while a gross receipts tax, even one with a "high telecommunications tax rate," would have only a "minimal

2. In 1986, AT&T filed a tariff containing the GRTS to eliminate this incentive and produce equality of treatment between states with excise or sales taxes and states with gross receipts taxes. Under the GRTS, AT&T recovers the state taxes on interstate gross receipts directly from the customers in the few states that impose the tax.

The GRTS has had its intended effect. By November of 1989, when the FCC issued its decision upholding the GRTS, five states had repealed or reduced their gross receipts taxes, thus reducing the costs of, and rates for, interstate telecommunications service. Pet. App. 53a.

3. Section 202(a) of the Communications Act, 47 U.S.C. § 202(a), does not prohibit all rate differences between like services. It prohibits only "unreasonable discrimination." Furthermore, contrary to petitioners' apparent assumption that only differences in cost can justify differences in rates, courts have consistently held that rate disparities are justified as long as they have a "neutral, rational basis" which promotes the objectives of the Communications Act.[3] The FCC and the Court of Appeals applied this standard in upholding the GRTS.

The FCC concluded that AT&T's surcharge was a reasonable mechanism for allocating specific costs "directly to the originator of those costs," and eliminating the "incentive to target telecommunications carriers for special tax burdens and thereby export the cost of the tax to customers in other states . . . ." Pet. App. 37a-38a. The Court of Appeals upheld this reasoning as "unassail-

---

impact" on Connecticut residents because its cost would be borne largely by out-of-state customers, and be a "hidden tax." Finance, Revenue & Bonding Comm., Connecticut General Assembly, *Final Report of the Connecticut Telecommunications Task Force*, 95, 99-100, 116 n.5 (1986).

[3] *See, e.g., AT&T* v. *FCC*, 832 F.2d 1285, 1293 (D.C. Cir. 1987); *Reservation Tel. Coop.* v. *FCC*, 826 F.2d 1129, 1136 (D.C. Cir. 1987); *National Assoc. of Reg. Util. Comm'rs* v. *FCC*, 737 F.2d 1095, 1133 (D.C. Cir. 1984), *cert. denied*, 469 U.S. 1227 (1985).

able," *id.* at 11a, and observed that, in the absence of the GRTS, the inevitable result would be an "upward-spiraling" of long-distance rates "bearing no relation to actual costs of service." *Id.* The Court of Appeals concluded that preventing that prospect was "well within" the Commission's statutory mandate to assure reasonable charges for interstate telecommunications service. *Id.*

In so holding, the FCC and the Second Circuit simply followed the uniform decisions of state courts and state regulatory commissions that adopted this precise rationale and held that "flow throughs" of municipal taxes to that municipality's ratepayers do not violate the analogous nondiscrimination provisions contained in state regulatory statutes.[4]

---

[4] *See, e.g., Allocation of Local Utility Gross Receipts Taxes Among Consumers,* Opinion No. 81-22, Case No. 27611 (Oct. 29, 1981 N.Y. Pub. Serv. Comm'n); *City of Des Moines* v. *Iowa State Commerce Comm'n,* 285 N.W.2d 12, 16 (Iowa 1979); *Peoples Gas Sys.* v. *Lynch,* 254 So.2d 371, 373 (Fla. Dist. Ct. App. 1971), *cert. denied,* 267 So.2d 81 (1972); *Village of Maywood* v. *Illinois Commerce Comm'n,* 23 Ill.2d 447, 178 N.E.2d 345 (1961), *cert. denied,* 369 U.S. 851 (1962); *City of Scottsbluff* v. *United Tel. Co.,* 171 Neb. 229, 240-245, 106 N.W.2d 12, 19-22 (1960); *State ex rel. City of West Plains* v. *Public Serv. Comm'n,* 310 S.W.2d 925, 929-33 (Mo. 1958); *Ogden City* v. *Public Serv. Comm'n,* 123 Utah 437, 443, 260 P.2d 751, 754 (1953); *State ex rel. Pacific Tel. & Tel. Co.* v. *Department of Pub. Serv.,* 19 Wash.2d 200, 273-78, 142 P.2d 498, 533-38 (1943), *aff'g as modified,* 37 P.U.R. (N.S.) 321, 404-05 (Wash. Dep't of Pub. Serv. 1940); *City of Elmhurst* v. *Western United Gas & Elec. Co.,* 363 Ill. 144, 146-48, 1 N.E.2d 489, 490-91 (1936); *In re Chesapeake & Potomac Tel. Co.,* 12 P.U.R.3d 517, 519-25 (Va. State Corp. Comm'n 1956) (collecting cases); *In re Western Light & Tel. Co.,* 10 P.U.R.3d 70, 79-80 (Mo. Pub. Serv. Comm'n 1955); *In re Southern Bell Tel. & Tel. Co.,* 7 P.U.R. (N.S.) 21, 33 (N.C. Utils. Comm'n 1934).

Petitioners are simply wrong in claiming that the Colorado Supreme Court struck down an "analogous" surcharge in *City of Montrose* v. *Public Utilities Commission,* 590 P.2d 502 (Colo. 1979), and three subsequent decisions of that court. Pet. 26-30. The surcharge at issue in each case applied to the franchise fees which had been imposed by some municipalities in Colorado upon gas utilities as a *substitute* "for the actual cost to [the utility] of carrying on its

4. Petitioners do not challenge the lower court's interpretation of Section 202(a). Instead, their principal contention is that the decision of the Court of Appeals "is not supported on the record and is contrary to significant ratepayer and consumer interests." Pet. 21.

This is plainly wrong. The history of Connecticut's own gross receipts tax shows the incentive states would have, in the absence of the GRTS, to adopt what Connecticut itself called a "hidden tax" in order to export their tax burdens to citizens in other states. *See supra* pp. 3-4 & n.2; Pet. App. 11a, 52a-53a. Further, the record also demonstrates that states have responded to the GRTS by repealing or reducing their gross receipts taxes, and thus reducing the costs of interstate long-distance service and promoting the objectives of the Communications Act. Indeed, because these are the same findings that state tribunals have made for decades (*see supra* p. 5 n.4), they plainly are reasonable.

5. Petitioners also contend that the failure of the FCC to hear oral testimony "constitutes an abuse of discretion under the circumstances of the instant case." Pet. 37. This contention is frivolous. Petitioners had a full hearing. They made lengthy written submissions of testimony and argument, and were permitted extensive discovery against AT&T. Because there were no credibility

---

business" within the municipality. *City of Montrose* v. *Public Utils. Comm'n*, 590 P.2d at 505. The court in each case held that because these fees were merely a substitute for such costs (i.e., condemnation and repair costs that would otherwise have been imposed), they should be "similarly expensed" as an averaged cost rather than surcharged. *Id.* Connecticut's gross receipts tax, in contrast, is not a substitute for any other cost of doing business. Moreover, the regulatory order establishing the franchise-fee surcharge had been adopted "solely as a matter of administrative convenience," *id.* at 506, and not, as with the FCC order, in order to eliminate incentives which would artificially increase the cost of service. The Colorado Supreme Court was not faced with, and thus did not address, the validity of the reasoning that formed the basis of the FCC decision approving the GRTS.

determinations to be made, and because the petitioners' testimony on other costs associated with providing long-distance service in Connecticut was legally irrelevant, the FCC's refusal to receive oral testimony plainly did not constitute an abuse of its broad discretion to resolve complaints "in such manner and by such means as it shall deem proper." 47 U.S.C. § 208(a) (1988).

6. Finally, this case has no continuing practical significance because Connecticut repealed its gross receipts tax effective January 1, 1990. Pet. App. 53a. This constitutes an independent ground to deny the petition.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be denied.

Respectfully submitted,

FRANCINE J. BERRY
DAVID P. CONDIT
295 North Maple Avenue
Basking Ridge, NJ 07920
(908) 221-2000

DAVID W. CARPENTER *
PETER D. KEISLER
SIDLEY & AUSTIN
One First National Plaza
Chicago, IL 60603
(312) 853-7000
Counsel for Respondent American Telephone and Telegraph Company

February 27, 1991

---

* *Counsel of Record*

NO. 90-1008

IN THE
SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1990

CONNECTICUT OFFICE OF CONSUMER COUNSEL
CONNECTICUT DEPARTMENT OF PUBLIC UTILITY CONTROL
CONNECTICUT ATTORNEY GENERAL, Petitioners,

v.

FEDERAL COMMUNICATIONS COMMISSION
UNITED STATES OF AMERICA, Respondents,

AMERICAN TELEPHONE AND TELEGRAPH COMPANY, Intervenor.

REPLY TO BRIEF IN OPPOSITION

BILL KOWALSKI
136 Main St., Suite 501
New Britain, CT 06051
(203) 827-7887
Counsel of Record

RICHARD BLUMENTHAL
ATTORNEY GENERAL
STATE OF CONNECTICUT

ROBERT S. GOLDEN, JR.
One Central Park Plaza
New Britain, CT 06051
(203) 827-2620
Counsel for Petitioner

TABLE OF CONTENTS

NOTE: On January 9, 1991, Richard Blumenthal succeeded Clarine Nardi Riddle as the Attorney General for the State of Connecticut.

TABLE OF AUTHORITIES

The Decision On Appeal Is Directly Antithetical To The Goals Of The Federal Communications Act Of 1934

One of the undisputed essential goals of The Communications Act of 1934 was the creation and provision of a universal, nationwide system of telecommunications. This system was established in large part through the creation of a nationally-averaged pool of costs, costs shared by all telecommunications customers through nationally-averaged rates. Such rates historically did not discriminate between customers on the basis of such differences in the national system as state-specific taxing schemes, infrastructure costs, or population densities. All of that changed, however,

with the FCC's approval of AT&T's Connecticut gross receipts tax surcharge.

The Second Circuit Court of Appeals' tacit approval of the segregation of Connecticut's gross receipts tax from AT&T's national pool of all other expenses, through the surcharge at issue, sets a dangerous precedent which is antithetical to the goals of the Federal Communications Act. Moreover, the court's decision establishes this precedent without an evidentiary hearing or cost of service study, required in this case to examine the appropriateness of the action in light of the factual issues raised before the FCC but unresolved to this day. (See Petition for Writ of Certiorari at 38-39.) In so doing, the Court of Appeals has sanctioned an arbitrary and capricious agency decision.

As a result, Connecticut customers of AT&T have been forced to pay not only the full expense of the gross receipts tax levied upon AT&T in Connecticut, but also a portion of all non-gross receipts taxes levied upon citizens of all fifty states, while receiving service no different than that received in any other state. Such a result constitutes unreasonable rate discrimination, that is not validated by the Second Circuit's claim that the absence of a more ubiquitous taxing scheme in Connecticut justified the discrimination.

Because of the nature of interstate telecommunications, and its use of the local telephone company franchise to complete long distance calls, interstate telecommunications companies such as AT&T are allowed an opportunity to earn millions of dollars in annual revenues in

a particular state utilizing only a minimal level of taxable in-state property. As the FCC indicated in their opposition in this proceeding,

> All long distance calls require the use of both local telephone plant and long distance facilities. A typical long distance call begins on an individual subscriber's local loop, travels through local switches to long distance lines, and ultimately returns to another local system where the recipient of the call resides or does business.
>
> FCC Opposition, footnote 2, p. 3.

The right of states to charge utilities with franchise fees for the use of the public right-of-way, and for other benefits provided by the states, is universally acknowledged and uncontested in this proceeding. The unique nature of utility service in general warrants exceptional, rather than ubiquitous tax

treatment. Because of the utilization of the local telephone utility infrastructure by long distance telecommunications companies, at "both ends" of any long distance call, a unique rather than ubiquitous taxing structure is not only appropriate, but necessary for the establishment of an effective taxation structure.

Existing federal statutes contain adequate protections and remedies for any party alleging that a state's taxation of long distance telecommunications has resulted in unreasonable rates. See 47 U.S.C. §§ 201, 202 and 208.

The record in this proceeding is devoid of any evidence that any other state, individual or other entity has filed a complaint with the FCC objecting to Connecticut's gross receipts tax policy, a policy first established over

one hundred years ago. As indicated in the Petition for Writ of Certiorari, the only objections on record in these proceedings were raised by other state consumer advocates and state agencies against AT&T's surcharge proposal. (Petition, pp. 10-11.)

By affirming the gross receipts tax surcharge, the Second Circuit Court of Appeals has affirmed unreasonable rate discrimination, and thus has established the first significant degradation of nationally-averaged rates since the passage of the Telecommunications Act of 1934, without so much as an evidentiary hearing.

CONCLUSION

For these various reasons, the Petitioners urge the Court to grant their Petition for Writ of Certiorari.

Respectfully submitted,

BILL KOWALSKI
136 Main Street, Suite 501
New Britain, CT 06051
(203) 827-7887
Counsel of Record

RICHARD BLUMENTHAL
ATTORNEY GENERAL
STATE OF CONNECTICUT

ROBERT S. GOLDEN, JR.
One Central Park Plaza
New Britain, CT 06051
(203) 827-2620
Counsel for Petitioner